REPORT OF THE GOVERNOR'S COMMITTEE ON TAX ADMINISTRATION

# TAX ADMINISTRATION

## Improving the Business Climate in Pennsylvania

Report of the

Governor's Committee On

# TAX ADMINISTRATION

Improving the

Business Climate

In Pennsylvania

March 1965

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COMMONWEALTH OF PENNSYLVANIA
**THE GOVERNOR'S COMMITTEE ON TAX ADMINISTRATION**
Post Office Box 105
Harrisburg, Pennsylvania 17108



March 9, 1965

The Honorable William W. Scranton,

Governor of the Commonwealth of Pennsylvania

Dear Governor Scranton:

There is transmitted herewith the report of the Governor's Committee on Tax Administration, which you appointed in the Fall of 1963.

The Committee has concluded its work convinced that the administration of taxes in Pennsylvania can and should be improved. The Committee commends you and your interested cabinet members for recognizing the need and charging the Committee with the task of reviewing tax administration in Pennsylvania.

The Committee wishes also to commend the Department of Revenue, the Auditor General and his Staff and the Secretary of the Board of Finance and Revenue and his Staff for their acceptance of the Committee and its purposes as a public-minded endeavor to improve tax administration and the business tax climate in Pennsylvania and for their open-minded response to the needs of the Committee.

The success of the work of any committee depends in large measure on the effectiveness of its staff assistance. The Pennsylvania Economy League, Inc., State Division, provided staff assistance to the Committee and the

Committee wishes to acknowledge its debt to the Economy League, and particularly to Robert S. Lewis, Acting Director, State Division, who served as Secretary and Research Director to the Committee, for able, patient and indefatigable assistance at all stages of the Committee's work.

The Committee submits this report with its recommendations in the firm belief that if these recommendations are implemented, the business tax climate in Pennsylvania will be improved to the benefit of its citizens and Pennsylvania will have the most modern and efficient state tax administration in the Nation.

As explained in the Report, the Committee will file a supplemental report on valuation for Capital Stock and Franchise tax purposes when the Department of Revenue has completed its evaluation of the revenue effects of a valuation formula developed by the Committee.

Respectfully,

Leonard E. Kust

Leonard E. Kust
Chairman

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HON. JOHN K. TABOR
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* Resigned from the General Assembly, did not serve on Committee.

# THE COMMITTEE'S TERMS OF REFERENCE

## OBJECTIVES

This study is a part of Pennsylvania's broad program for industrial development. It is a part that is concerned with what is often referred to as "business tax climate."

The objectives of the study are, simultaneously, to improve the relationship between the State and its business taxpayers and to attain greater effectiveness in the administration and collection of business taxes as a means of advancing the interests of the people of Pennsylvania.

To accomplish these objectives this committee of business tax experts will analyze problem areas in tax administration and will recommend suggested changes to the Secretary of Revenue and to the Governor.

## SCOPE

The scope of the survey will be limited to the administration of corporate taxes and will not include substantive tax revision. Reference may be made to other taxes which affect corporate taxpayers with a view toward improvement, in accordance with the objectives stated above. It is emphasized that the scope of the study will be further subject to two major limitations:

(1) It will be directed to tax administration as practiced by the Department of Revenue and other responsible State agencies. Where changes in existing law are deemed advisable by the Committee, recommendations for such changes should be framed; but, in addition, an alternative recommendation within the framework of existing law should also be developed.

(2) It should be clearly understood that this study concern itself solely with the administration of specific taxes as outlined herein. While attention may therefore be given to the organization and procedures of certain related offices of the Department of Revenue it is not expected that this constitute a general administrative study of the Department.

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NOTE: Taken from the Prospectus approved by the Committee December 19, 1963.

# INTRODUCTION

## Origin of the Committee on Tax Administration

The Governor's Committee on Tax Administration had its origin in the Governor's Council of Business and Industry, organized in January 1963 by Governor William W. Scranton. The Council early in its deliberations was confronted with evidence of misunderstanding and friction between business taxpayers and Commonwealth tax administrators. It thereupon recommended to the Governor that he

> "arrange for a conference to include policy makers in the Department of Revenue, tax consultants representing private companies, both within and outside the Commonwealth, various business organizations, and a few selected business institutions with major tax problems, to discuss possible administrative improvements, the objective being to demonstrate the desire of state government to improve the business tax climate."

Two such conferences were held in 1963, the first in April and the second in June, each attended by different groups of taxpayers. Extended discussion of business tax problems at these meetings led to the suggestion that a committee be established to study in depth the problems discussed and to make recommendations. This suggestion was conveyed to the Governor, who responded by appointing in the fall of 1963 a Committee on Tax Administration with the mission of analyzing problem areas in tax administration and recommending changes to the Governor and the Secretary of Revenue.

## Taxes and Business Climate

The concern of business over the impact of taxes on costs of operation is as old as both business enterprise and tax systems. Although decisions

as to the location of manufacturing or distribution sites usually hinge on many factors, for example, accessibility to raw materials or markets and transportation, labor or utility costs, the relative burden of state and local taxes is also a consideration. Over the past decade or more there has been a growing awareness of the part that tax burdens may play in influencing industrial development.

One aspect of taxes as related to business tax climate has not received the same attention. This is the nature and the quality of the administration of taxes and the resulting degree of understanding — or lack of it — between government and the taxpayer. Quality of administration is important to both the business taxpayer and the individual taxpayer. The rates and bases of business taxes are much more complex, however, than are those of personal taxes. Therefore, the administrative problems are greater and so also are the opportunities for misunderstanding between government and taxpayer.

Entirely apart from the direct cost of taxes, the business taxpayer may sense an unfavorable climate if:

> Statutes imposing taxes are vague and printed regulations are vague or non-existent so that he finds it difficult to determine his liability; or
>
> Administration of taxes is so vague or obscure that he has doubts as to whether he is receiving treatment in equitable parity with that accorded his competitors; or
>
> Procedures for settling differences between the State and the taxpayer over tax liability are cumbersome and inconvenient or fail too frequently to resolve the issues.

The Governor's Council of Business and Industry, recognizing this situation in its 1963 report, noted:

"A number of less tangible factors in need of improvement in the state fall in the area of 'business climate' and widely-held 'impressions' with respect to Pennsylvania. The members of the Council believed these less easily measured factors might be of more immediate importance and more urgently in need of improvement than some of the substantive areas already discussed.

"As we proceed with the discussion of these factors it will readily be seen that many of them are of a type with which the business decision makers who will have the final responsibility for the creation of jobs in our state may well become emotionally involved and tend to decide at times on the basis of opinion as much as on fact.

"On the other hand many of these more emotion-prone factors are such that immediate improvement can be made by an agreement on the part of all of our citizens that this improvement is needed and that we will join hands to bring it about."

Referring specifically to "tax climate" the Council said further:

"Pennsylvania is often accused of having a bad 'tax climate.' It should be noted parenthetically that 'tax climate' seems to be a summation in the minds of many people of a number of specific irritants, including tax rates, the punitive and hostile nature of tax administration...."

On the subject of State tax laws and their administration the Council said:

"It would also appear from evidence put before us that some of our tax laws are rather broadly drawn and leave to the Department of Revenue a good deal of administrative latitude. It was reported to the Council from a number of sources that in the establishment and implementation of administrative policies, state officials have often exhibited in the past a rather arbitrary attitude, especially in matters of assessment and collection, and that these individuals oftentimes have been difficult to work with once they have taken a position."

It was this last comment which led to the Council's recommendation that State officials at the policy-making level meet with tax consultants and business representatives to discuss possible administrative improvements.

The subsequent actions to create the present Committee received the full endorsement of the Council.

Committee Procedures

As noted in the Prospectus, the objectives of the study by the Committee on Tax Administration are:

> "simultaneously, to improve the relationship between the Commonwealth and its business taxpayers and to attain greater effectiveness in the administration and collection of business taxes as a means of advancing the interests of the people of Pennsylvania."

The Committee held its organization meeting December 19, 1963. The Pennsylvania Economy League was formally requested, and agreed, to provide research staff services.

During the early months of 1964, officials from the State agencies responsible for the administration of taxes met with the Committee and discussed their organization and procedures and answered questions. These agencies included the Department of Revenue (Corporation Tax and Sales and Use Tax Bureaus), the Department of Auditor General, the Department of State and the Board of Finance and Revenue.

Information on tax administration was assembled in loose leaf form including pertinent statutes, forms, and organization charts as well as written statements on procedures by the State officials who met with the Committee.

Statements concerning problems in tax administration were solicited and received from members of the Committee and from business taxpayers through such statewide organizations as the Pennsylvania Manufacturers' Association and the Pennsylvania State Chamber of Commerce. These

comments were classified and summarized for study by the Committee.

In March, the Committee was further organized into five sub-committees to permit more intensive study of the major problem areas identified during the preliminary months of study. The problem areas were:

(1) departmental organization for tax administration;

(2) tax administration and the fiscal code;

(3) field operations;

(4) valuation, allocation, and formulary direct pay;

(5) tax communications, returns, collections.

The sub-committees, meeting bi-weekly, then worked independently during the spring and early summer months studying the respective areas. Field trips by the Chairman, the Vice-Chairman and the Secretary of the Committee, and in one case by the members of the sub-committee on Valuation, Allocation and Formulary Direct Pay, were made to other states, which after preliminary investigation appeared to offer useful parallels for the guidance of the Committee. The states visited were Massachusetts, Michigan, Ohio, New York and Wisconsin where interviews were held with the chief tax administrators and private tax practitioners. The Committee wishes to acknowledge and to express its appreciation of the full and time-consuming cooperation of the tax administrators and practitioners. By mid-summer the reports and recommendations of the five sub-committees were completed and distributed to the full Committee. During the fall, meetings of the full Committee were held to consider the sub-committee findings and recommendations and to integrate them into a final report.

## The Committee's Scope

The concern of the Committee has been solely with the administration of State taxes paid by business in Pennsylvania. It has not been the function of the Committee in any way to study or make recommendations concerning the rates or the bases of State taxes, nor to consider changes which would either increase or decrease the yield from taxes, except to the extent that increases in tax yield can be expected as a by-product of improved tax administration,or recommended formula aids to administration may affect the revenues. In general, the Committee concerned itself with the administration of the Corporate Net Income tax (including under this term the Corporation Income tax), the Capital Stock and Franchise taxes, the lesser corporate taxes, and the Sales and Use tax of which an important portion is paid by business and which is in total collected and remitted by business. Some recommendations in the report apply to the administration of specific taxes, others apply generally.

The Committee recognized that proper organizational structure and observance of the cardinal tenet that authority must be commensurate with responsibility are fundamental to good administration. The concern of the Committee was specifically directed to improvement of the business tax climate through elimination of unnecessary friction and uncertainty and the Committee has sought to offer solutions for the evident specific problems which it found or which were brought to its attention. But the larger solution which commended itself was that proper organization and competent staffing, and proper procedures for resolving controversies are the ultimate

answer to the problems of effective and equitable administration without the injury to the business tax climate which has in many respects characterized Pennsylvania. The nature of the tax system, particularly the determination of value for purposes of the Capital Stock and Franchise taxes, which is considered in further detail in this report, has contributed materially to the problem.

Most of the problems would not arise or at the least would be solved as part of the proper discharge of the administrative function, given the right definition of responsibility and authority, the right organization, the right staffing and the right procedures. Attention to these fundamental conditions of good tax administration was considered to be an essential part of the Committee's work (1) as a foundation for aiding in the solution of existing problems and for carrying out the specific suggestions of the Committee with respect thereto, and (2) as assurance that new problems of inadequate administration and of taxpayer friction would be diminished in the future.

The Report of the Committee, accordingly, addresses itself first to the organization and responsibility for tax administration and administrative and appeals procedures and then to the specific problems in the areas of field operations, valuation and allocation, and communications.

## SUMMARY OF FINDINGS AND RECOMMENDATIONS

The Governor's Committee on Tax Administration divided its study into five major segments. Four of the five relate to specific problem areas of tax administration. The fifth concerns overall departmental organization, staffing and the assignment of authority for tax administration. The Committee believes that the organizational recommendations will serve (1) as a foundation for correcting and resolving existing problems and for carrying out specific Committee suggestions, and (2) as assurance that future problems of inadequate administration and taxpayer friction will be diminished.

### II

### Organization and Responsibility for Tax Administration
(Pages 15 to 26) *

The Committee's studies and findings in this area are based upon two major premises. First, modern day tax administration requires an organization vested with authority and professional competence to perform its assigned duties. Second, the functions of tax administration should include assistance to the Governor in the development of tax policy and in the administration of State taxes.

The Committee finds that a number of responsibilities vested in the Department of Revenue are only remotely related to tax administration or are not related at all, whereas certain functions necessary to sound tax administration are not adequately provided for. It finds an absence of tenure

* Page references refer to appropriate chapter where findings and recommendations are discussed in detail.

for a large portion of departmental employes, irrespective of their qualifications and positions, as well as low starting salaries — two factors that combined, make it difficult to attract competent personnel. Finally, the Committee finds that the Department of Revenue shares certain responsibilities for tax administration with the Auditor General and with the Attorney General.

THE COMMITTEE RECOMMENDS THAT —

The following departmental organization be established:

Secretary of Revenue and Executive Deputy Secretary

A Deputy Secretary for Operations, reporting to the Secretary, with responsibility, through appropriate bureaus, for the enforcement of all State taxes.

A Deputy Secretary for Technical Services, reporting to the Secretary, also to be Chief Counsel, appointed by the Attorney General upon recommendation of the Secretary, with responsibility for legal interpretation and the drafting of rules and regulations.

A Director for Economic Research and Statistics, reporting to the Executive Deputy Secretary, responsible for tax and economic research and statistics, and for the publication of reports.

The Department be divested of all non-tax functions, such as motor vehicles and institutional collections.

The entire Department be placed under civil service coverage up through the level of bureau director, and salary levels be reviewed and fixed at a sufficiently high level to attract competent personnel.

Necessary statutes be amended to eliminate the required approval of the Auditor General in the settlement and resettlement of certain taxes.

## III

### Administrative and Appeals Procedures
(Pages 40 to 54)

An important area of tax administration is the determination of tax liability for business taxpayers and the resolution of disagreements over liability between the taxpayers and the Commonwealth.

In studying problems that have arisen here the Committee finds that the lack of adequate rules and regulations has contributed to uncertainty and to misunderstandings on the part of taxpayers. Lack of uniformity in procedures and time periods for administrative appeals is confusing and unnecessary. The participation of the Auditor General in the settlement and resettlement of certain taxes, although carried out with a high degree of cooperation, serves to dilute the primary responsibility of the Department of Revenue for tax administration. The Committee finds that the ex-officio membership of the Board of Finance and Revenue creates problems because of lack of adequate time to devote to tax problems and because the Board often does not act as a unit. Finally, the Committee finds that the failure to provide for refunds of overpaid or improperly collected taxes is an anachronistic survival necessitating trafficking in credits among taxpayers.

THE COMMITTEE RECOMMENDS THAT —

> A statutory obligation be imposed on the Secretary of Revenue to issue rules and regulations governing both procedures and substantive interpretations of tax laws.
>
> Uniform procedures be established by law as follows to be adhered to by the Department of Revenue where deficiencies are to be assessed: (The confusing terms "settlement" and "resettlement" would be eliminated.)

The taxpayer shall receive notice of a proposed deficiency and have 30 days to protest and to request an informal conference with the Department. The Department may either enter into an agreement with the taxpayer as to liability or, after conference, issue a notice of deficiency. The taxpayer shall have 90 days to appeal to a Board of Tax Appeals. (This procedure contemplates elimination of the Auditor General from the settlement process as already recommended.)

An independent Board of Tax Appeals be established by law as follows to hear appeals from Department determinations:

The Board shall be composed of three members appointed by the Governor for nine-year staggered terms and its staff shall be under civil service. A taxpayer may elect to have the Board's decision in his case based either on a verified statement of facts or on a record made in accordance with rules of evidence prescribed by the Board. The Board shall, in each case in which it renders a decision, prepare and publish a written opinion. Compromises of pending cases shall be entered as decisions of the Board without opinion and shall not be appealable. Decisions of the Board, other than by compromise, shall be subject to appeal to Commonwealth Court, either by the Department or the taxpayer, and the proceedings before the Court shall be de novo or on the record, depending on whether a record was made before the Board. A decision of the Board of Tax Appeals, if not appealed to the Court, shall be a precedent binding on the Department in other cases, unless the Department obtains an opinion from the Attorney General that the decision is erroneous.

A three-year statute of limitations apply to the assessment of a deficiency by the Department (except in case of fraud) and to the filing of a claim for refund by a taxpayer; this limitation to be extended by mutual agreement; a two-year statute of limitations to be applicable to suits for recovery of refunds erroneously made or for refund of a deficiency erroneously paid by a taxpayer.

Refunds allowed by the Department or determined by the Board of Tax Appeals or the Court, together with interest, be paid or credited to the taxpayer at his election.

## IV

## Audits and Investigations
(Pages 57 to 59 and 69 to 74)

Daily contact with taxpayers makes the field operations staff of the Department public relations personnel as well as enforcement agents. The manner in which they carry out their responsibilities has a bearing on Pennsylvania's business image.

Field operations of the Bureau of Corporation Taxes and of the Bureau of Sales and Use Taxes are very different in size and scope and therefore are discussed separately. In corporation taxes the Committee finds that a relatively small force of auditors and investigators is spread rather thinly and that none is covered by civil service. The use of the combined audit, i. e., a single audit of a tax account for both corporate and sales tax audits made by the same auditor, had been suggested to the Committee. The Committee finds that the combined audit has not proven satisfactory in states where it has been tried and is not popular with taxpayers. The Committee finds that the minimum capital stock valuation results in a tax ($5.00) for a large number of taxpayers that is less than the cost of processing returns. Finally, the Committee finds existence of a problem where incorporated bars, restaurants, and hotels can transfer or sell liquor licenses before settlement of outstanding State taxes, making difficult the collection of back taxes.

THE COMMITTEE RECOMMENDS THAT —

A program of combined audits not be instituted.

Consideration be given to amending Pennsylvania's Capital Stock and Franchise Tax Act to provide for a minimum tax (filing fee) of $25.00.

The Liquor Control Board be given statutory authority to delay transfer of liquor licenses until back taxes have been paid.

With regard to the Sales tax the Committee finds that there has been substantial improvement in the quality of audits in recent years and for this it commends the Bureau. The Committee believes that as the State's experience with the Sales tax increases the number of field investigators can be reduced and the size of the audit force increased. It finds that civil service coverage of field personnel remains too limited and low starting salaries make it difficult to attract the most competent people. The Committee also finds that the Department is not using to the full, statutory enforcement powers already available to it.

THE COMMITTEE RECOMMENDS THAT —

Improvement in the quality of audits remain a continuing goal for the Bureau of Sales and Use Tax.

The sales tax audit force be increased to the equivalent of one auditor for every 700-800 accounts and that the number of audits per auditor be increased.

Consideration be given to further reduction in the field investigator force.

Sales and Use tax regulations be definitive in nature, be given widespread distribution to licensees and exhaustively reviewed with field auditors and investigators, and that decisions concerning taxable and exempt transactions be made immediately available to all field auditors and licensees.

The Bureau of Sales and Use Tax make greater use of the powers of enforcement it now possesses and, in addition, that the Sales tax law be amended to provide the Bureau with additional powers to collect deficiencies.

With regard to the salary levels and civil service coverage of field personnel in the Department, reference is made to the recommendation in Chapter II on departmental organization for full civil service coverage within the Department and for the raising of salaries to a more competitive level.

## V

## Valuation and Allocation
(Pages 81 to 91)

Problems of tax valuation and allocation considered by the Committee related almost entirely to the Capital Stock and Franchise taxes and to the Corporate Net Income tax. With respect to tax valuations, it was made clear that the discretion of the Department of Revenue in valuation matters constitutes a prime irritant to taxpayers doing business in Pennsylvania. In the case of allocation, a major concern is the apparent preferential treatment for corporations doing business in but not incorporated in Pennsylvania.

The Committee finds that the valuation of capital stock for purposes of the Capital Stock and Franchise taxes is confused by a lack of officially sanctioned rules, guidelines or formulae. It is believed that this vagueness leads to suspicion of discriminatory treatment and even of corruption. At the least it makes difficult the anticipation of tax burdens, particularly by new businesses considering entering the Commonwealth. The uncertainty and suspicion which surround Capital Stock and Franchise tax valuation have been a most damaging aspect of the business tax climate in Pennsylvania.

The Committee considered two approaches to the valuation problem. One would be the promulgation of guidelines illustrating for taxpayers the

considerations involved in capital stock valuation. Guidelines would preserve existing departmental discretion in seeking to achieve equity, but would still be generalized and thus leave taxpayers uncertain. The second approach would be the adoption of a mathematical formula. Such a formula was developed and considered by the Committee. It involves the selection by the taxpayer of three of four factors based on net income, dividends, net worth and the selling price of stock. The Department of Revenue is evaluating the effect of this formula on State revenue yields and on individual taxpayers. Following the receipt and consideration of the Department's findings the Committee will issue a supplemental report giving its recommendations with respect to valuations.

The Committee finds no widespread dissatisfaction with application of the allocation formula under the Corporate Net Income tax. However, a recent Congressional study of interstate taxation has dwelt upon the diversity of state formulae for allocation of gross receipts and the resulting overlapping of tax liabilities. In the belief that Congress may otherwise enact a mandatory allocation formula, there is a move underway to secure adoption by all states of a uniform formula in which gross receipts would be allocated primarily on a destination basis. The Committee finds that the destination basis is more compatible with the attraction of new and the expansion of old business in Pennsylvania than the present basis of allocation of gross receipts.

The Committee finds a source of taxpayer irritation in the existing allocation of intangible assets of corporations doing business in other states in addition to Pennsylvania. Under the Capital Stock tax applicable to

domestic corporations, such property is assigned entirely to Pennsylvania. Under the Franchise tax applicable to foreign corporations such property is allocated under a three-part formula based upon payroll, property, and gross receipts. Many domestic corporations feel that this difference places a higher tax burden on them.

On a matter only partially related to valuation and allocation the Committee finds that development by the Department of special recording procedures for formulary methods for reporting Use tax by direct-pay permit holders has been helpful to taxpayers but that its use is still relatively limited.

THE COMMITTEE RECOMMENDS THAT —

> Taxing memorandum #16 of 1959 governing the allocation of wages, salaries and gross receipts, under the Corporate Net Income tax and the Franchise tax be withdrawn, and that the "Uniform Division of Income for Tax Purposes Act," as drafted by the National Conference of Commissioners on Uniform State Laws be adopted, omitting paragraph b of Section 16 of such act.
>
> The allocation formula under the Capital Stock tax be amended to conform to the uniform formula contained in the previous recommendation.
>
> The Department of Revenue give more publicity to the formulary procedures for direct-pay permit holders under the Use tax and explore ways and means of extending its use to large and small taxpayers.

## VI

### Communication Between State and Taxpayer
(Pages 95 to 103)

Printed communications, such as rules and regulations, tax forms and instructions, statistical reports, represent a primary link between the taxpayer

and the Commonwealth. The State's tax image thus depends to a large extent upon the quality and the quantity of these communications.

The Committee finds that there is at present no procedure in the Bureau of Corporation Taxes to clarify and publish regulations concerning tax policy. Regulations have been few, issued sporadically, and made available only to taxing officers and not to taxpayers. Sales tax rules and regulations have been almost equally sparse (except for a "tentative" manual issued in 1956), but the Bureau of Sales and Use Taxes is currently in the process of preparing a complete set of regulations. The Department of Revenue also lacks any regular statistical publication.

The Committee finds that present corporation tax forms are sufficiently cumbersome to be an obstacle to the average businessman and that instruction for using the forms are inadequate. Finally, it finds that the practice of maintaining taxpayer accounts on an individual type of tax basis is a hinderanc to informing the taxpayer of his tax status.

THE COMMITTEE RECOMMENDS THAT —

> Regulations governing all State taxes be printed and maintained in current form for public distribution and that when the Sales tax regulations now being drafted are completed an announcement of their availability be included in the next mailing of tax forms.
>
> The Department of Revenue provide pamphlets for specific corporation taxes or groups of taxpayers containing tax law and regulations of interest to the parties concerned.
>
> The Secretary of Revenue establish an advisory Committee composed of business tax experts to meet with him regularly for consultation on problems of tax administration and proposed changes in regulations, procedures or forms.

The Department of Revenue review all corporate tax forms with a view toward simplification and clarification based on the considerations stated below:

(a) Elimination from the Corporate Net Income tax form of the detail for determining net income and substituting taxable income as reported to the Federal government;

(b) a short form for corporate net income tax use by taxpayers who have no allocation to be considered;

(c) simple forms dealing with valuation for use by taxpayers not eligible for allocation or for exemption under the Capital Stock and Franchise taxes;

(d) elimination of that portion of the tax form covering settlement;

(e) separate report forms for corporate taxes if the above considerations cannot accomplish a significant simplification.

The Bureau of Corporation Taxes prepare a set of procedural instructions to accompany tax returns.

A unified basis of accounting be developed by the Department which will result in a single net ledger balance for each taxpayer reflecting all corporate tax liabilities and payments, and that each taxpayer then be furnished an annual statement of his account balances.

I

# AN OVERVIEW OF THE TAX STRUCTURE AND PRESENT RESPONSIBILITY FOR TAXES

An understanding of the magnitude and the recent evolution of tax revenue sources and the present responsibility for the administration of taxes in Pennsylvania will help place the ensuing discussion of tax administration in perspective.

## Existing Tax Structure

There are two kinds of revenue, tax revenue and non-tax revenue. Non-tax revenues usually include intergovernmental revenues (e.g., federal aid), licenses, fees, service charges, etc. Pennsylvania taxes may be grouped broadly into types of tax, such as consumer taxes, business taxes, and other taxes.

Table 1 outlines the tax structure of the Commonwealth, listing actual 1963-64 yields, those estimated for 1964-65 and the percent of each tax to the estimated return in the General Fund in 1964-65.

About one-half (49.6%) of the total tax yield in the General Fund is received from one tax — the Sales tax. The Corporate Net Income tax presently accounts for 15.0% of total taxes. Total business taxes yield 28.2%. In the Motor License Fund the major state tax is the Liquid Fuels tax (and the Fuels Use tax). It has an estimated yield equivalent to 23% of total General Fund taxes.

The major components of the Commonwealth's tax structure have undergone significant change in the last ten to 15 years. The Corporate

Table 1

Pennsylvania Taxes and Revenues
Fiscal Years Ending in 1964 and 1965

(Dollar Figures in Thousands)

| | Actual 1963-64 | Estimated 1964-65 | Percent Gen. Fun[d] Taxes 1964-65 |
|---|---|---|---|
| GENERAL FUND | | | |
| Corporate Business Taxes | | | |
| Corporate Net Income Tax | $154,046 | $156,700 | 15.0% |
| Capital Stock & Franchise Tax | 58,591 | 63,100 | 6.1 |
| Corporation Excise Tax | 2,358 | 2,085 | .2 |
| Corporate Loans Tax | 1,827 | 1,905 | .2 |
| Total | $216,822 | $223,790 | 21.5% |
| Selective Business Taxes | | | |
| Utilities Gross Receipts Tax | $ 26,100 | $ 27,400 | 2.6% |
| Bank Shares Tax | 16,192 | 17,000 | 1.6 |
| Insurance Premiums Tax | 24,207 | 24,600 | 2.4 |
| Other Selective Business Taxes | 1,047 | 1,010 | .1 |
| Total | $ 67,546 | $ 70,010 | 6.7% |
| Total Business Taxes | $284,368 | $293,800 | 28.2% |
| Consumption Taxes | | | |
| Education Sales & Use & Hotel Tax | $512,768 | $517,000 | 49.6% |
| Cigarette Tax | 89,411 | 97,700 | 9.4 |
| Liquor Tax | 39,835 | 40,875 | 3.9 |
| Malt Beverage Tax | 21,124 | 20,600 | 2.0 |
| Total | $663,138 | $676,175 | 64.9% |
| Other Taxes | | | |
| Realty Transfer Tax | $ 20,984 | $ 20,800 | 2.0% |
| Inheritance Tax | 51,774 | 51,000 | 4.9 |
| Miscellaneous Taxes | 533 | 550 | - |
| Total - All Taxes | $1,020,797 | $1,042,325 | 100 % |
| Total-Non-Tax Revenues | 102,854 | 102,050 | |
| TOTAL GENERAL FUND REVENUES | $1,123,651 | $1,144,375 | |
| MOTOR LICENSE FUND | | | |
| Liquid Fuels & Fuels Use Taxes | $ 223,231 | $ 239,050 | |

Net Income tax was originally levied at a rate of 6% in 1935, with an additional deduction allowed for federal taxes. This additional deduction was disallowed after 1943. Between 1936 and 1955, the rate fluctuated from a maximum of 10% to a minimum of 4%. Since 1955 it has been at 6%. The tax was considered a temporary revenue, subject to reenactment at each biennial session; in 1957, it was made permanent.

The most important change in the Capital Stock and Franchise taxes, which are based on the value of the capital stock of a corporation employed in Pennsylvania, the first on corporations organized under the laws of Pennsylvania and the second on corporations organized elsewhere, has been the reinstatement, effective since 1958, of the manufacturing exemption. The exemption had been removed in 1935 and its restoration was postponed during the post-war period. The exemption applied to the capital stock of manufacturing corporations which was invested in or used for manufacturing purposes in Pennsylvania. The exemption was expanded in 1961 to apply to "processing," and in 1963 to apply to research and development.

The sales tax was introduced in modern day Pennsylvania with enactment in July 1953 of the Consumers Sales tax for a limited two-year period at a rate of 1%. The tax applied only to designated kinds of sales. After the Consumers Sales tax was allowed to expire, and prolonged debate, a Selective Sales and Use tax was enacted in March 1956, also applicable to sales of enumerated items of tangible personal property, at a rate of 3%. The rate was increased to 3 1/2% in April 1959 and to 4% in August of the

same year. In May 1963, the rate was increased to 5% and the tax converted from a selective to a general levy. (The tax was renamed "The Tax Act of 1963 for Education" but will be referred to in the remainder of this report as "The Sales Tax.") The conversion was made without significant decrease in the number of exemptions.

Exemptions from the Sales tax are too numerous to discuss in detail but those applying to food for off-premise consumption and clothing are of major significance. Important to business is the exemption applicable to equipment, machinery and supplies used directly in manufacturing and public utility service. The exemption was extended specifically to processors in 1961.

Most significant over the past decade has been the shift away from reliance on direct business taxes to finance Commonwealth general government. Data prepared by the Department of Revenue ([1] show that the portion of general fund revenues raised from direct business taxes has shrunk from 46% in 1953 to 21.1% in 1963. A major factor in this change has been the Sales tax, which has become the major revenue producer.

<u>Allocation of Responsibilities</u>

The responsibility for collection of state taxes is vested in the Department of Revenue, with the exception only of the Corporation Excise tax, which is collected by the Department of State. A portion of the Department of Revenue's administrative responsibility for corporation taxes is shared,

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1) Pennsylvania's Improved Tax Climate - Department of Commerce, March, 1964.

in that the Auditor General must approve settlements and resettlements of corporation taxes arrived at by the Department, and, the Attorney General must approve rules and regulations issued by the Department.

Other departments also have a voice in tax matters via the Board of Finance and Revenue. This is an ex-officio board composed of the following:

Treasurer, Chairman

Auditor General

Secretary of Revenue

Secretary of the Commonwealth

Attorney General

The Board of Finance and Revenue has the responsibility, subject to petition to it, for reviewing and revising tax assessments or settlements arrived at by the Department of Revenue or by that department and the Auditor General jointly. This Board is the top level for administrative review of state taxes in the Commonwealth. The Board also hears and determines petitions for refunds and designates depositories for state moneys.

Departmental organization and responsibilities for tax administration are analyzed in detail in other chapters of this report.

## II

## ORGANIZATION AND RESPONSIBILITY FOR TAX ADMINISTRATION

### In General

The Committee appraised the responsibilities and performance of the Department of Revenue to determine its appropriate functions, and the organization and personnel essential for the most effective operation. The first conclusion was that modern-day tax administration requires an organization vested with authority and the professional competence to perform its duties in a manner commensurate with its responsibilities. To achieve this requires an organization headed by a person who derives his authority from the Governor and who is trained and qualified in the field of tax administration, with assistants also qualified by training and experience in taxation, to discharge the responsibilities of the Department. Supporting the highest department levels should be a staff of technical and clerical persons appointed on the basis of ability to do the job, with assurance of satisfactory salary, working conditions, and tenure.

The Committee, in appraising the responsibilities of the Department, concluded also that the functions of tax administration should include assistance to the Governor in the development of tax policy and the administration of state taxes. After all, modern tax administration is more than just a matter of collecting taxes. It is a professional function requiring professional and specialized competence with a recognized coherence and should be so organized. It has no relationship to the licensing of motor vehicles or motor vehicle operators. It has nothing to do with the traffic safety program

of the Commonwealth.

It should be pointed out that such conclusions did not arise full-blown, as though they were pre-packaged and awaiting selection. They came, instead, only after discussion and study of specific points of friction and misunderstanding made it clear that part of any study had to be a consideration of the agency itself, not just a procedure-here and a process-there. It was apparent for example, that one could hardly suggest urgently needed new legal remedies such as an appeals board in the absence of a clearly defined organizational structure that could be held responsibly accountable for its actions. The absence of written rules and regulations, clear channels of communications, and knowledgeable departmental representatives, just cannot be considered apart from the basic organization.

Development of Present Organization

The Department of Revenue, established in 1927, was another example of the wave of administrative reform that characterized Pennsylvania state government in the 1920's. The objective was two-fold, 1) to consolidate under one roof all the state revenue collection duties and to make them the responsibility of one agency, and 2) to permit the Department of Highways to concentrate its efforts on the rapidly developing highway construction and maintenance program. The legislature transferred to the Department of Revenue from the Highways Department the responsibilities for collecting the liquid fuels tax, the fees charged motor vehicle operators, and the responsibility for the highway patrol. The latter was transferred by the

legislature in 1937 to the State Motor Police (later designated the State Police). In addition, the Department of Revenue assumed the revenue collection responsibilities previously shared by the Auditor General, the Treasurer, the Insurance Commissioner, and other smaller agencies. Although established in 1927, most of its responsibilities were not assumed until 1929. Since then, except for the transfer of the highway patrol, the Department's functions have remained as established. It has continued to be the revenue collection agency for the State and, as revenue sources have expanded, has assumed these added responsibilities. The same can be said for its non-revenue responsibilities, such as motor vehicles and traffic safety.

## Present Organization

The Department of Revenue is organized around the two major revenue producing funds, the General Fund and the Motor License Fund (see chart in Appendix). Each fund has a deputy who oversees these bureaus and the activities related to each of these funds. An executive deputy secretary supervises the two "fund deputies" as well as the staff functions that assist in the day-by-day internal running of the Department. Below these top levels are the operating bureaus. Some are organized around a specific tax, others are organized around groups of taxes or other revenue collection responsibilities. One, the Bureau of Traffic Safety, is organized separately.

Bureau of Corporation Taxes. This Bureau employs 309 persons in five divisions, and is headed by a Director. The Bureau administers 17 separate tax statutes, and is responsible for planning and coordinating the administration of the corporation tax program and for formulating corporation tax policy. Approximately 86,000 corporate taxpayers are obliged to report under these tax laws, which in 1963-64 produced $284.3 million. The divisions of the Bureau are:

1. Receipts & Deposits: distributes report forms and settlement notices and receives all corporate tax returns and payments.
2. Accounting: maintains ledgers for 86,000 corporate taxpayers, and analyzes them for transfer credits and delinquencies.
3. Taxing and Resettlement: establishes tax liability on the basis of reports filed.
4. Field Services: conducts audits of corporations.
5. Legal: provides legal interpretations of tax laws and performs research in corporation tax law.

Bureau of Sales and Use Taxes. This Bureau employs 896 persons in four divisions, and is headed by a Director. The Bureau is responsible for imposing and collecting the sales, use and hotel occupancy taxes which are levied at a uniform rate of 5%. Collections are actually made through business establishments, the total number of which was 225,648 as of the

end of 1963. Revenue from this tax now exceeds $500 million annually. The divisions are:

1. Accounting: responsible for processing returns of businesses licensed to collect the tax.
2. Legal: responsible for acting as general counsel to Bureau.
3. Field Operations: responsible for conducting audits and investigations of businesses throughout the State.
4. Office Services: provides the "housekeeping" needs for the Bureau.

Bureau of County Collections. This Bureau employs about 160 persons in four divisions, headed by a Director, and is collecting about $85 million for the General Fund. The Divisions are:

1. Inheritance Tax: responsible for obtaining compliance with inheritance and estate tax laws.
2. Realty Transfer Tax: responsible for enforcing the realty transfer tax act.
3. Escheats: responsible for discovering and auditing abandoned and unclaimed funds and other personal property and for transferring them to the custody of the state until a rightful owner can be found.
4. Miscellaneous Licenses: responsible for collecting fees for fish, boating, game and other licenses.

Bureau of Investigations and Collections. This Bureau employs 164 persons in a headquarters division and a field headquarters. The Bureau is responsible for administering and enforcing the laws governing cigarette taxes, malt beverage tax, spiritous and vinous liquor taxes, and motor vehicles fines imposed by the minor judiciary.

Bureau of Institutional Collections. This Bureau employs 260 persons located in the state general hospitals, state mental hospitals and schools, correctional facilities, state colleges, and state youth camps. The Bureau is responsible for billing patients or those liable (private or public persons or agencies) for services rendered.

Bureau of Liquid Fuels Tax. This Bureau employs 79 persons in two divisions, auditing and administration. The Bureau is responsible for collecting the tax imposed on liquid fuels, such as gasoline, and diesel fuels.

Bureau of Motor Vehicles. This Bureau employs 1,514 persons organized in nine divisions, all located centrally in Harrisburg. The Bureau is responsible for the collection of all fees and taxes for the issuance of vehicle licenses and certificates, and vehicle operators' licenses. During the rush season, 50-75 more persons are temporarily employed.

Bureau of Traffic Safety. This Bureau employs 560 persons in eight divisions, headed by a Commissioner, who determines how the legislative mandate of the Governor's traffic safety program will be implemented. Responsibilities include the supervision of the drivers' licensing, suspension

and revocation program; administration of the financial responsibility law, the semi-annual inspection law; and, approval of lighting and other safety devices for vehicles.

Staff Units. Supporting the operating bureaus are several additional services, all of which are under the direct charge of the Executive Deputy Secretary. Together, they employ about 200 persons. They are:

1. Fiscal Management: directs and coordinates Department's budget.
2. Internal Audits: conducts audits of financial operations within Department to insure proper compliance with laws and policies.
3. Management Methods: performs surveys for management concerning layout, space, automation, methods and procedures.
4. Personnel: provides personnel for Department.
5. Service and Supply: procures equipment, supplies and materials; and, services bureaus of Department.
6. Research and Statistics: makes estimates and forecasts of existing and proposed revenues.

Executive Offices. The Secretary and the deputies each have a staff. Total personnel are about 45. In addition, the Comptroller, who has 32 persons employed, acts as the chief accounting officer for the Department.

Civil Service in Department

The Department has a total complement of more than 4,600 persons, of whom more than 90% are appointed outside the civil service system, and thus must be politically sponsored. The eight or nine percent covered by civil service are technical personnel, such as accountants, data processing personnel and most auditors in the field operations divisions of the major taxing bureaus. Some of the field auditing personnel who had been covered by civil service prior to 1963 were taken out of civil service by the 1963 amendments to the Civil Service Act which, while blanketing in most of the positions already included, removed from the civil service all supervisory positions the duties of which included participating in policy decisions. This has been interpreted to include supervising auditors in regional and district offices of the major tax bureaus of the Department. A list of the personnel transactions for 1963 illustrates the activity of the political sponsorship system in the Department:

| | | | |
|---|---|---|---|
| Applicants interviewed (approx.) | 5000 | Number of salary increases | 1421 |
| Number of new appointments | 2595 | Number of promotions | 147 |
| Number of separations | 2560 | Number of demotions | 96 |
| Number of retentions (approx.) | 600 | Number of transfers | 31 |

Salaries

Apart from the absence of civil service in most of the Department's operations, the Committee had indications that salaries for tax administration personnel, particularly at the beginning levels, are inadequate. A salary survey conducted by the Governor's Office of Administration in mid-

1964 shows that starting salaries for many personnel engaged in tax administration are lower, on the average, than most comparable states (see Table 2 in Appendix). Since the state's policy is to hire at the lowest step in the salary range except in unusual and extenuating circumstances, the already difficult task of attracting skilled accountants, auditors, and other taxing personnel is compounded.

## FINDINGS AND RECOMMENDATIONS

Mindful of the discussion regarding the role of modern professional tax administration in a large industrial state, the Committee makes the following findings.

1. A number of Departmental responsibilities are only remotely related to tax administration, and some are not related at all.
2. An absence of tenure exists for thousands of Department employes, irrespective of their qualifications and position, due to political sponsorship.
3. Salary levels in the taxing bureaus are not adequate to attract and to hold the most competent personnel.
4. A dual responsibility exists between the Secretary of Revenue and the Attorney General with respect to appointing Department counsel, and with respect to promulgating tax rules and regulations.

5. A dual responsibility exists between the Secretary of Revenue and the Auditor General with respect to settlement and the resettlement of the Corporate Net Income and the Capital Stock and Franchise taxes.

6. Certain functions are not adequately provided for in the departmental organization.

As mentioned earlier, the Department of Revenue was established to put under one roof the responsibilities for collection of all Commonwealth revenues and to relieve the Department of Highways to permit it to concentrate on the growing highway construction and maintenance program. Since 1927, however, the tax collecting and non-tax collecting responsibilities of the Department have increased substantially. In March, 1933, the Department had a total of 1,614 employees (including the highway patrol of 610 at that time), and made collections for the General and Motor License Funds of about $160.6 million. By 1940 this staff totalled 1,345 (highway patrol was transferred to State Police in 1937) and collections were about $315 million. More recently, collections have gone past the $1 billion mark annually, and there are now more than 1,345 employes in the three major taxing bureaus alone (Sales, Corporation, County Collections).

As the tax yields and administrative staffs have increased over the years, so has the number of taxes. But more importantly, the administration

of existing as well as newer taxes has become challenging and difficult out of all proportion to mere numbers. The reasons are not mysterious. The number of business taxpayers is enormous and the diversity of businesses today knows no limitations. Hence the scope of the administration of business taxes must reflect this situation and cope with it accordingly. For example, a 1927 [1] report showed that the Commonwealth received for the 1926 fiscal year $44,838,198 in corporate taxes from more than 25,000 corporations that reported. Most of this sum, however, came from approximately 15,000 corporations with 90% or more of their tangible property domiciled in Pennsylvania. In 1963-64 corporate taxes exceeded $284 million from more than 86,000 corporations (foreign and domestic), most of them much more complex and diversified than their 1927 counterparts. Thus, the job of tax administration has become much larger and more complicated.

Organization and Responsibility of the Department of Revenue

The Committee believes that an organizational pattern that emphasizes the operations aspect of taxes is preferable to the present method which emphasizes specific taxes. The operations approach is much more efficient, assuming it is competently administered, for it brings together under a unified command all the tax knowledge and expertise in the Department subdivided according to its function, e.g., enforcement, interpretation or evaluation and compilation. Moreover, it makes possible the efficient use of centralized

1) Source: Final Report of the Pennsylvania Tax Commission, 1927.

accounting and record-keeping. With such an approach the Department of Revenue could be effectively organized on the lines set forth in the following discussion.

Deputy Secretary for Operations. This office comprehends the enforcement function and should have the responsibility for the collection and auditing of all taxes whether imposed for the general fund or for special funds. For administrative purposes the office should be divided into several bureaus, each headed by a director for the collection of the several major taxes. The following bureaus would appear to be appropriate for the present. However, as changes in the tax pattern occur the Secretary of Revenue should have the authority, subject to the approval of the Executive Board, to create or enumerate such bureaus as conditions may warrant.

The Bureaus suggested for the present are:

a. Bureau of Sales and Use Tax
b. Bureau of Corporation Taxes, including
   (1) Corporate Net Income tax
   (2) Capital Stock and Franchise taxes
   (3) Gross Receipts taxes
   (4) Insurance Premium taxes
   (5) Harness Racing taxes
   (6) Bank Shares taxes
   (7) Other Selective Business taxes
c. Bureau of Inheritance Taxes, including Escheats
d. Bureau of Liquid Fuels Taxes
e. Bureau of Miscellaneous Taxes, including
   (1) Cigarette tax
   (2) Malt Beverage tax
   (3) Liquor tax
   (4) Realty Transfer tax
   (5) Other taxes

Deputy Secretary for Technical Services. The head of this office should also be Chief Counsel of the Department. The office comprehends the interpretive function and the head should have the responsibility for promulgating such rules and regulations as may be required for the proper administration of all state tax laws, subject to the approval of the Secretary of Revenue and of the Attorney General or his delegate. It should be the responsibility of this office to codify all state tax laws, to provide legal interpretations requested of the Secretary of Revenue, and to represent the Department before the Board of Tax Appeals hereinafter recommended. All such rules, regulations, and interpretations and codifications should be published and be made available to interested taxpayers, or their representatives, and to other persons or groups interested in state tax administration.

The Deputy Secretary should have available a staff provided by a bureau of rules and regulations. Since the major functions of the office and its bureau of rules and regulations will be legal in nature, the technical staff will no doubt consist primarily of attorneys. The director of the bureau should be the Assistant Chief Counsel for the Department of Revenue.

Director for Economic Research and Statistics. This office, under the Executive Deputy, comprehends the evaluation and compilation function and should have responsibility for tax research and statistics. Its function should include the assembling, analyzing and evaluating of data required for tax estimating, analyzing economic trends, appraising economic effects of existing or proposed taxes, and the study of tax trends and problems in other states particularly those of importance to Pennsylvania. (The Committee found

the lack of continuing statistical analysis in the Department a serious impediment to knowledgeable tax administration. This lack makes difficult and uncertain estimates of revenue loss or gain with respect to proposed changes to laws or regulations.)

In addition, this office should conduct such special studies as may be of interest and value to the Governor, the Department of Revenue, and the public. It should be responsible for publishing reports on such studies as may be of general interest, and also for preparing an annual report of the Department of Revenue.

The Director for Economic Research and Statistics should be a person of established competence in economic and statistical analysis. He should be assisted by a staff provided by two divisions, one for economic research and a second for revenue estimating and other statistical services. Each division should be under the supervision of a chief competent to engage in the economic and statistical work assigned to it. Each division should have a fully adequate staff of persons trained in economic research and statistics.

Director of Staff Services. A Bureau of staff services, headed by a director under the Executive Deputy should be charged with the housekeeping duties of the Department such as budgeting, personnel, procurement, office procedures and systems, and other related management aids to the operating programs.

In-service training in techniques of operation should be the responsibility of each of the operating offices. However, in-service and orientation

programs for departmental clerical and other general departmental staff, and for the technical and professional employes of this bureau, and related personnel tasks should be conducted and coordinated through this bureau.

Disposition of Non-Tax Functions. The Committee believes that the Department of Revenue could best carry out its function if it were relieved of certain activities which are not primarily concerned with tax administration. For this reason it is suggested that the Bureau of Motor Vehicles and the Bureau of Traffic Safety be removed from the Department of Revenue. These activities could be handled in a variety of ways. They could be merged with other licensing and safety inspections presently in the Department of State and the Department of Labor and Industry into a new department concerned with protection to persons and property, or transferred either to the Department of Highways or to the State Police.

The collection of other licenses and fees should be the responsibility of the departments administering and supervising the activities so licensed. Similarly, the various institutional collections should be the responsibility of the departments charged with the operation of said institutions.

THE COMMITTEE RECOMMENDS THAT —

1. The Department continue to be headed by a Secretary of Revenue and an Executive Deputy, with two Deputy Secretaries reporting directly to the Secretary, one for Operations and one for Technical Services, the latter serving also as Chief Counsel, and two Directors reporting directly to the Executive Deputy, one for Economic Research and Statistics and one for Staff Services. Further:

   a. The Bureau of Motor Vehicles and the Bureau of Traffic Safety be removed from the Department;

b. The collection of licenses and fees (for example, hunting, and fishing license fees) be the responsibility of the departments regulating the activities;

c. The collection of institutional moneys be the responsibility of the departments charged with the operation of such institutions; and

d. The Department of Revenue receive a daily notice of transmittal of all state moneys to the State Treasurer - no matter where originally collected - on a form prescribed by the Department.

The Attorney General

The Committee recognizes that under the Administrative Code (Section 902) the Attorney General is responsible for all the "legal business" of the state. Such a responsibility implies the corollary authority for assuring that persons who, as representatives of the Attorney General work for specific agencies full time, are qualified to perform those duties. This corollary seems to be recognized in the Administrative Code, (Section 906) although the authority is not stated as a duty of the Attorney General but rather a grant of power subject to the approval of the Governor.

On a related matter, that of promulgating rules and regulations, the Administrative Agency Law (Section 1710.21) specifies that approval of the Attorney General as to "legality" is required. The obtaining of such "legal" approval is required of agencies adopting rules and regulations; however, the presence of qualified attorneys in the Department of Revenue should make this approval unnecessary in the regular course. It would expedite the regulation and rule-making process if the Attorney General

delegated his responsibility to his appointee, the Chief Counsel of the Department of Revenue, and reserved only the right to intervene in circumstances which he deemed appropriate.

The Attorney General should have the right to appoint the Chief Counsel only on the recommendation of the Secretary of Revenue and the Secretary should have the unfettered right to dismiss the Chief Counsel. Thus, the Deputy Secretary and Chief Counsel would be in all respects responsible to the Secretary of Revenue, except that he would be appointed by the Attorney General on the recommendation of the Secretary and his delegated responsibility for approval of rules and regulations would be subject to intervention by the Attorney General.

The widest possible autonomy for the Department of Revenue is believed desirable, given the administrative procedures hereafter recommended, but retention of the right to appoint and the right to intervene on the part of the Attorney General, as above described, is believed to be desirable and consistent with the Attorney General's responsibility for all the "legal business" of the Commonwealth. In the Federal government the Chief Counsel of the Internal Revenue Service is a Presidential appointee who has no responsibility to the Attorney General, but it is to be noted that he is responsible to the General Counsel of the Treasury Department and not to the Commissioner of Internal Revenue. Moreover, in all the states examined by the Committee, the Attorney General of the state maintains some measure of control over legal matters involved in tax administration.

The recommendation of the Committee is believed to be a reasonable and effective accommodation of the several considerations involved.

THE COMMITTEE RECOMMENDS THAT —

2. The Chief Counsel, who also serves as Deputy Secretary for Technical Services, be appointed by the Attorney General on the recommendation of the Secretary of Revenue, and the Attorney General delegate his responsibility for approving rules and regulations to the Chief Counsel, subject only to his right to intervene, before a rule or regulation becomes effective under the procedure recommended in the next Chapter, in circumstances which he deems appropriate.

Civil Service

The merits of civil service versus non-civil service have been discussed since the Pendleton Act of 1883 that set up the original federal career system. In most states, the principle of hiring and firing on the basis of qualifications and competence, or some other system, has been settled in favor of the civil service system. However weak the civil service system may appear (and its weaknesses frequently can be traced to timidity in its administration) it is infinitely superior to the patronage system.

It was noted by Committee members visiting other states that surprise was expressed that a state as large as Pennsylvania continued to fill positions in its tax agency with politically sponsored applicants. Without exception in the states visited, the civil service system reaches up to the level just below the department head and his immediate deputies, and in some states, even to the immediate deputies. (New York, Massachusetts, Ohio, Wisconsin and Michigan were visited.) It is axiomatic that qualified and competent staff are absolute ingredients in any "going concern," for

as important as organizational structure is to effective tax administration, the recruitment of qualified staff and assurance of tenure based on performance are even more important. But qualified staff cannot be attracted unless the compensation is commensurate with public responsibilities. This is especially true for deputies, and bureau and division heads, but the compensation for all positions in the Department should be competitive with other governmental jurisdictions and private industry.

THE COMMITTEE RECOMMENDS THAT —

3. Civil service be established in the Department to the highest level consistent with administrative efficiency and execution of executive policy, specifically, that all positions legally be required to be filled under civil service law, with the exception of the Secretary and Executive Deputy, the two Deputy Secretaries and one secretary and one confidential clerk for each, and the 1963 amendments to the Civil Service law which exempted certain personnel from civil service not be applicable to the Department.

4. Compensation be fixed at a high enough level to attract competent professionally qualified personnel to perform the functions assigned, and compensation for all positions in the Department be reviewed periodically to assure that they are competitive with other governmental jurisdictions and private industry.

The Auditor General

While definition of responsibility is part of organizational structure and the Committee accordingly makes its recommendation at this point regarding the unification of responsibility for tax administration in the Department of Revenue and the elimination of shared responsibility with the Auditor General, the reasons for the Committee's recommendation with respect to the Auditor General are better stated against the background

of the present procedures for determination of tax liability and for administrative appeals discussed in the next chapter.

THE COMMITTEE RECOMMENDS THAT —

5. The statutes be amended to provide that the approval of the Auditor General in the settlement or resettlement of certain taxes not be required and that he be concerned only with post-auditing.

## III

## ADMINISTRATIVE AND APPEALS PROCEDURES

An important and sensitive area in the Commonwealth's relationship with its business taxpayers is the period beginning with determination of tax liability by the Department of Revenue and ending when the taxpayer (if he disagrees) has exercised his last appeal before the courts. This includes settlement and resettlement of corporation taxes, review and assessment and reassessment of sales taxes, administrative appeals procedures within the Department, appeals procedures before the Board of Finance and Revenue, and finally, judicial appeals. It may also include tax refunds or tax credits if it is determined that taxes have been overpaid.

The sensitivity of this area and existing problems were revealed in a variety of comments by taxpayers which were studied by the Committee. Major comments to which the Committee directed its attention are summarized below.

### Comments and Criticisms

#### Business Taxes Generally

1. The present composition and procedures of the Board of Finance and Revenue present a number of problems.

    a. The ex-officio membership of the Board is troublesome. Representatives of statutory officers on the Board should not be persons involved in the original settlement, nor persons from the Attorney General's office who would decide the merit of appeals from the decisions of the Board.

b. It is suggested that the Board be abolished and an independent Board of Tax Appeals be created in its place. The Board of Tax Appeals should be a quasi-judicial body, the members of which would have knowledge in the field of tax law, would have fixed terms of office and would be independent of the taxing department. The new Boards's employes should have civil service status.

c. Decisions of the Board state only the conclusions, not the facts and reasoning by which the conclusions are reached.

d. Prompt action by the Board is required both in arriving at resettlement and review decisions and in acting on refund petitions. Notice of Board action should be given the taxpayer within a reasonable period of time.

e. Board of Finance and Revenue decisions are not accepted by the Department of Revenue as establishing precedent.

f. Hearings of the Board now held only in Harrisburg should also be held in Philadelphia and Pittsburgh, as are those of the Resettlement Board.

g. Department counsel should be present at hearings of the Board of Finance and Revenue to argue the Commonwealth's case.

2. Complaint is voiced that judicial action on appeals is lagging. It is noted that delays of two to two and one-half years are not uncommon before arriving at decisions, resulting also in the deferment of tax settlements for subsequent years until the question at issue is resolved.

3. Businesses are assessed for interest on delinquent tax amounts but interest is not paid by the State when taxes have been overpaid.

Corporation Taxes

1. Presettlement conferences, at which taxpayers and tax officials of the State agree upon a settlement figure that will not be disturbed thereafter, should be reinstated. Alternatively, it is suggested that taxing officers should notify the taxpayer prior to

settlement or resettlement, concerning questions raised or positions proposed to be taken, in order to permit the taxpayer to provide answers or arguments.

2. Tax settlements, once made should not be resettled without conferring with the taxpayer. Resettlement under Section 1105 of the Fiscal Code without such conference denies the taxpayer an opportunity to be heard by representatives of the two taxing departments, since statutory procedure requires that petitions for review of such a resettlement must be presented to the Board of Finance and Revenue. It is further suggested that, as a matter of simple justice, the Department of Revenue, in the absence of fraud, should limit itself to one resettlement of any tax account, notwithstanding that no such statutory limit exists.

3. The settlement and resettlement certificates (i. e., notices of settlement and resettlement to the taxpayer) should also be used to notify the taxpayer that:

   a. If aggrieved by a settlement he may petition for a resettlement within 90 days on forms obtainable from the Department of Revenue. (Note: such a form is not now supplied)

   b. If aggrieved by a resettlement he may, within 90 days, seek relief therefrom by filing with the Board of Finance and Revenue a petition for review.

   The notices should also indicate taxes paid and/or transferred into the account.

4. The representatives of the Secretary of Revenue and the Auditor General assigned to sit as the resettlement board, should not have participated in the original settlement.

5. If refunds are not to be permitted, then improvements should be made in the handling of credits. The State should provide a complete accounting of all taxpayer accounts, whenever a taxpayer is called upon to pay a deficiency on a given tax, rather than request payment of one tax when there may be credits on another tax that could be transferred. It is suggested that the State maintain a single account for each taxpayer showing his standing on payments of all taxes. A statement of such account could be supplied the taxpayer periodically, possibly semi-annually. It is also suggested that administrative procedures be established for assignments of credits between companies at a reasonable discount value.

Sales Tax

1. Sales tax appeals procedures are cumbersome and throw too much burden on the taxpayer. Formal hearings before the Sales Tax Board are required, testimony is taken and witnesses are sworn. It is months following the hearing before there are any decisions. It is suggested that provision s be made for regional hearings on assessment appeals to eliminate the need for travel to Harrisburg.

2. Vendors should be allowed to offset, against sales tax due the Commonwealth, the amount of sales tax refunded to a customer because of returned merchandise - even though the original sale occurred in an earlier period.

3. Ninety-days should be allowed for the filing of appeals from the Department of Revenue with the Board of Finance and Revenue in sales and use tax cases.

## Existing Procedures

The Fiscal Code contains most of the administrative provisions governing state taxes except that administration of the Sales tax is provided in the tax act itself.

Provisions for the settlement of corporation taxes and for appeals at the department level are set forth in the Fiscal Code. ([1] The Corporate Net Income and the Corporation Income tax acts also have settlement and resettlement provisions, ([2] which, however, correspond to those in the Fiscal Code. Assessment and departmental appeals procedures for the sales tax are to be found in the act itself. ([3]

1) Fiscal Code (P. L. 343, April 9, 1929, as amended): Section 601, Article VII, Article VIII, most of Article XI.
2) Corporate Net Income Tax: Section 8, P. L. 208 of 1935 as reenacted and amended by P. L. 80 of 1957. Corporation Income Tax: Section 8, P. L. 1417 of 1951 as reenacted and amended by P. L. 66 of 1957.
3) Act of March 6, 1956, P. L. 1228, as amended to June 1, 1963: Sections 540 to 545.

Procedures, common to all state business taxes (sales tax included), for appeal to the Board of Finance and Revenue and then to the courts are contained in the Fiscal Code. (4

The Sales Tax act (Sections 550 to 556) provides for refunds of taxes. Corporation tax laws permit only credits where taxes are overpaid.

The time span covered by the determination of tax liability and the exercise of appeal rights - the subject of this chapter - includes such other matters as tax return forms, filing dates, penalties, desk and field audits. These are dealt with elsewhere in this report and therefore are not discussed here.

Determination of Tax Liability

Corporation taxes in Pennsylvania are self-assessed in that a tax return is filed and the tax is paid on the basis of the taxpayer's calculation of tax contained in that return. This applies to the general corporation taxes such as the Corporate Net Income, Capital Stock and Franchise, and Corporate Loans taxes, and to selective taxes such as the Gross Receipts, Insurance Premiums, and Bank Shares taxes. The Domestic Corporation Excise tax is administered by the Department of State, the remaining taxes by the Bureau of Corporation Taxes of the Department of Revenue.

Following receipt of the tax return, tax liability is determined by the Department through the process of making "settlement," which is based

4) Fiscal Code: Article V, Sections 1103, 1104.

upon a review of the tax return together with any information that may be asked for and received from the taxpayer. This work is assigned to taxing units, according to the size of the valuation shown on the return. There are two "A" taxing units for valuations up to $200,000, one "B" unit for $200,000 to $2 million valuations, and one "C" unit for valuations in excess of $2 million. All returns over $2 million are also reviewed by the Director of the Bureau of Corporation Taxes.

The Department will grant a presettlement conference upon request by a taxpayer. (No notice is given to the taxpayer that he is entitled to such a conference.) Presettlement conferences were once a long standing practice on the part of the Department, but were eliminated in 1956. They were reinstated early in 1963 although the fact has not been made known through any officially promulgated public announcement.

The settlement made by the Department of Revenue is then subject to approval by the Department of the Auditor General, which must act within 60 days. In order to carry out this duty the Auditor General maintains a hand-written ledger of all taxpayer accounts. This actually amounts to bookkeeping duplicating that of the Department of Revenue, although the latter department states that the ledger at present is a help in preventing errors. The dual review and computation of taxes by the two departments faces a deadline fixed by Section 801 (b) of the Fiscal Code which says that all settlements must be finished and the taxpayer notified before the end of the year succeeding that for which the return was filed.

If the Auditor General and the Department of Revenue do not agree on a tax settlement or resettlement within four months the case goes to the Board of Finance and Revenue. The Board is directed to give such cases precedence over other business and to reach a decision within three months. If it fails to reach a decision the original settlement of the Department of Revenue thereupon becomes valid. Officials have stated that disagreements arise in about five percent of the cases and are usually resolved by the two departments.

When the tax is settled a tax settlement notice is sent to the taxpayer which consists of a photo-copy of the settlement section of the tax return, showing the computation used in arriving at the tax liability. If the taxpayer disagrees with the settlement, he has 90 days in which to file a petition for resettlement. He is not automatically notified of his appeal rights, but must find out for himself.

The sales tax is paid on the basis of the computation made by the taxpayer in a quarterly or monthly return filed with the Department. The Department examines the return (either an office audit or a field audit) and, if it determines that a greater amount of tax is due than that shown on the return or than actually remitted, it issues a notice of assessment to the taxpayer. A taxpayer receiving a notice of assessment has 30 days within which to notify the Department of his intent to petition for a reassessment. Deficiencies may result from underpayment of tax shown on returns, returned checks, late returns, or understatement of tax.

Departmental Appeals Procedures

A corporation tax settlement may be appealed by filing a petition for resettlement with the Department within 90 days after receiving the notice of settlement. Such a petition is heard by the Secretary of Revenue and the Auditor General or their representatives (usually the latter) sitting as a Resettlement Board - an informal designation not specifically provided by law. The Board is composed of taxing officers and attorneys from the Department of Revenue and tax auditors from the Auditor General's department. Most hearings are held in Harrisburg, although, upon request, some are also held in Philadelphia and Pittsburgh as a convenience to taxpayers. Petitions must be disposed of by the two departments within six months of their filing.

If the taxpayer's contentions in the petition are denied, he is notified by mail. If a resettlement is granted, he receives a certified copy of the resettlement. A taxpayer who is dissatisfied with the decision of the board has 90 days in which to file a petition for review with the Board of Finance and Revenue. A resettlement may be made without a hearing if the departments agree with the basis for the taxpayer's petition.

An additional resettlement provision is available to the Department of Revenue which is not available to the taxpayer. Section 1105 of the Fiscal Code provides that within two years of the date of any settlement or resettlement, the Department of Revenue, with the approval of the Auditor General, may make a resettlement of the account either increasing

or decreasing the tax. This provision does not apply where an appeal has been taken. Provisions dealing with possible disagreement between the two departments are the same as those applying to an original settlement. A taxpayer whose account has been resettled under this section also has 90 days in which to file a petition for review with the Board of Finance and Revenue.

A sales tax assessment may be appealed by petitioning the Department for reassessment. Notice of intention to file such petition must be given the Department within 30 days of the assessment, although the time may be extended to 90 days for cause. Following receipt of such notice of intention the Department must furnish the taxpayer with a statement setting forth in reasonable detail the basis for the assessment. The taxpayer thereupon has 30 days in which to file his petition. The Department holds such hearings as are necessary and must dispose of the petition within six months of receiving it. The hearings are conducted by two Sales Tax Boards. These are non-statutory boards established by the Department, each consisting of three members, at least one of whom is an attorney.

The Boards conduct hearings and have the power to issue subpoenas. Hearings need not follow technical rules of evidence and procedures; however, when issues of fact are involved oral testimony is taken under oath. Because of the workload of appeals confronting the Boards, the Department has hearing examiners in each district office who hear testimony of appellant taxpayers and who prepare written reports for consideration by the Boards.

In addition to petitions seeking relief from assessments, the Boards also act upon taxpayer petitions for refunds. Decisions of the Boards are final unless there is a divided vote, then the case goes to the Secretary of Revenue for final decision. No decision of a board invalidating any rule or regulation of the Department is final unless and until approved by the Attorney General.

Following a decision by a sales tax board, the taxpayer has 60 days in which to petition the Board of Finance and Revenue for review.

Refunds

There is a lack of uniformity in the remedies afforded taxpayers for over-payment of state taxes. The Sales Tax act provides for the refund of sales taxes that have been overpaid and authority to act is vested in the Department of Revenue. Cases may go to the Board of Finance and Revenue upon petition of a taxpayer from an adverse decision. Provision for refunds also is contained in the inheritance tax law. These provisions, together with corresponding refund provisions in the Inheritance Tax Act, are implemented by periodic executive authorizations by the Governor to provide the amounts needed to pay refunds.

The various corporation and business tax acts make no specific provision for refunds. Any action to secure refunds must be brought before the Board of Finance and Revenue and necessary funds can be provided only by appropriation.

A part of the problem concerning corporate tax refunds arises from the provision in Section 16, Article III of the Pennsylvania Constitution, which provides that "no money shall be paid out of the Treasury except upon appropriation made by law." This section was amended in 1961 to permit "cash refunds of taxes, licenses, fees and other charges paid or collected, but not legally due" to be paid, "as provided by law without appropriation from the fund into which they were paid, on warrant of the proper officer."

Senate Bill 190 of 1963 would have implemented this amendment by permitting the refund of overpaid taxes without specific appropriations. This bill was vetoed by the Governor on the grounds that it contained no requirement for executive authorization and, therefore, he would have lacked adequate control over the fiscal position of the Commonwealth. In his veto message he also pointed out that refunds are being made out of current appropriations.

Sales tax refunds are made on the basis of a petition by the taxpayer which must be filed within 18 months of the payment of the tax. The Bureau of Sales and Use Tax reviews petitions for refund through its Sales Tax Board. Such petitions may result from overpayment of tax by error or from changes in the law, or be the outgrowth of court decisions relating to exemptions.

If the taxpayer's petition is not acted upon favorably he then may petition the Board of Finance and Revenue, following the same procedures

as in other actions before that Board. According to statements by Bureau officials before the Committee, the Bureau's current policy is to issue credit memoranda against future tax liabilities rather than to requisition necessary authorizations to pay refunds.

In the absence of adequate procedures for the refund of corporation and business taxes the practice is to allow credits against future tax liabilities. A resulting practice has also arisen: the sale or exchange of tax credits among businesses.

Board of Finance and Revenue

The Board of Finance and Revenue is a statutory board composed of the Auditor General, the Treasurer, the Secretary of Revenue, the Attorney General and the Secretary of the Commonwealth. Customarily, designated representatives of these officers sit on the Board. Although the prime concern in this report with respect to the Board is its duty to hear and determine petitions on tax settlements and assessments and petitions for refund, the Board has other responsibilities. The Board also hears petitions for the refund of escheated money, approves depositories for State monies, supervises the administration of the State sinking fund, and administers the agricultural reimbursement of liquid fuels taxes. The secretary to the Board has stated that sales and use tax and corporation tax cases constitute about one-half the total case load but consume about 80 percent of the Board's time.

The State Treasurer (or designate) acts as Chairman of the Board. Three members constitute a quorum and the Board's powers and duties must all be exercised on the basis of a majority vote. Historically, the Board is a combination of and successor to three Boards known as the Board of Public Accounts, the Board of Revenue Commissioners, and the Sinking Fund Commission. The staff of the Board - other than clerical - includes the secretary, an administrative officer, and four attorneys who serve as briefers. There are no positions under civil service.

The Board of Finance and Revenue has six months in which to act upon petitions for review of tax cases. If the Board fails to act in that time, the petition is considered sustained. The Board secretary reported to the Committee that the Board attempts to bring all cases to hearing within three months of the petition date and that it is now current on sales and use tax and corporation tax cases. Following a decision by the Board of Finance and Revenue the taxpayer has 60 days in which to file an appeal to the Court of Common Pleas in Dauphin County.

A petition filed with the Board is docketed and referred back to the Department in which the case originated. The Department then submits to the Board its entire file on the case together with comments and recommendations. Staff personnel on the Board review the material and prepare a formal brief for the Board setting forth the positions of the Department and of the taxpayer, a review of precedents, a line of reasoning, and a recommendation for action. The petitioner and the Department then

appear before the Board at its monthly meeting. The taxpayer may appear in person or be represented by counsel, or both. Although the taxpayer may also be represented by a person other than a lawyer, such person may not raise or discuss legal questions. The Board adopts its own rules of procedure.

Upon reaching a decision in a tax case, the Board issues a final order, of which the taxpayer receives a copy. The order contains only the Board's decision. The only record of the findings and conclusions which provide the basis for the decision is contained in the brief which is retained by the Board. There is no procedure for making this information available — even anonymously — to the taxpayer or to the taxpaying public.

## FINDINGS AND RECOMMENDATIONS

It is not feasible in connection with appeals procedures or in other areas of tax administration to make a full and complete comparison between Pennsylvania and all other states in the nation. However, available information indicates that there are certain aspects of assessment and appeals procedures wherein Pennsylvania stands apart from accepted and more modern practices in other states. This conclusion is based in part on a study made by the Federation of Tax Administrators [5] as well as on the field trip made by committee representatives to other states and the personal knowledge of members of the Committee.

5) State Administrative Tax Review: Organization and Practices. Federation of Tax Administrators, May, 1958. Updated to 1964 by correspondence.

One such aspect is the participation of the Auditor General in the process of making settlement of corporation taxes (usually referred to as "assessments" in other states). Corporate tax laws in Pennsylvania specify that settlements of taxes must have the approval of the Auditor General. This means that settlements arrived at by the Department of Revenue must be approved by the Auditor General, that representatives of the Auditor General sit with revenue representatives as an informal board to decide on resettlement and, in effect, that the Auditor General approve any regulations for tax valuation promulgated or adhered to by the Department of Revenue. So far as is known such division of responsibility in tax administration between the Revenue Department and a state auditor or controller does not exist in any other state. Tax administrators in states visited by the Committee expressed surprise at and deplored the divided responsibility imposed by this statutory practice followed in Pennsylvania and stated that the activities of their auditor or controller with regard to tax administration were limited to the usual post-audit function.

The second such aspect concerns the ex-officio composition of the Board of Finance and Revenue. The report made by the Federation of Tax Administrators reveals that of 11 states which have separate administrative boards concerned primarily with tax appeals, Pennsylvania is one of only three states in which the Board is composed of state officials serving in an ex-officio capacity. The other two states are North Carolina and Michigan. (In the case of Michigan the jurisdiction of the Board is limited

to corporation taxes, appeals from other taxes are handled by a separate board.) In the remaining eight states the members of tax review boards are appointed by the Governor and serve exclusively in this capacity.

In addition, the Committee makes the following findings:

1. The lack of adequate rules and regulations has contributed to uncertainty on the part of taxpayers and to misunderstanding between taxpayers and tax administrators.

2. The lack of uniformity in procedures and time periods for taking procedural steps in administrative appeals with respect to different taxes is confusing and unnecessary.

3. The lack of uniformity in nomenclature with respect to administrative procedures for the several taxes is confusing and unnecessary. The use of the terms "settlement" and "resettlement" with respect to the Capital Stock and Franchise, and Corporate Net Income taxes is unique to Pennsylvania and is misleading and obscure.

4. The failure to provide for refunds of overpaid or improperly collected taxes is an anachronistic survival necessitating trafficking in credits among taxpayers at premiums or discounts, depending on the circumstances.

## Regulations

The Committee believes that the complete absence of regulations for some taxes and the lack of adequate regulations governing other taxes, as discussed earlier in the report, has been a factor underlying various of the problems expressed at the beginning of this chapter. This is true with regard to the need for presettlement conferences, the volume of appeals from departmental settlements, and information to the taxpayer on procedures to be

followed in making appeals. The Committee believes that firm and clear regulations are needed, but that these must be treated in a somewhat more flexible manner than procedures set forth in statutes or arising from judicial interpretation.

THE COMMITTEE RECOMMENDS THAT —

1. An obligation to issue rules and regulations consistent with the law governing both procedures and substantive interpretations of the tax laws be imposed on the Secretary of Revenue by statute, such statute also providing that such rules and regulations shall be for the guidance of taxpayers and of employes of the Department of Revenue, but shall not be binding on or presumed consistent with the law by the Board of Tax Appeals (as hereafter recommended) and the Courts, and that the Secretary shall specify a period not less than 30 days from the date of issuance of a rule or regulation or any amendment thereof during which comments will be received and at the end of which the rule or regulation or amendment shall become effective unless withdrawn in the meantime by the Secretary.

Determination of Liability

Full authority for reviewing and auditing tax returns and for determining either deficiencies or overpayment should be vested in the Department of Revenue. Responsibility for the administration of tax policy in the final analysis rests with the chief executive and should be centralized in the appropriate executive department — in this case the Department of Revenue — not shared with a separately elected state office. The present responsibility of the Auditor General for approving corporate tax settlements represents an incomplete transition from tax administration in Pennsylvania prior to creation of the Department of Revenue and the enactment of the present Fiscal Code and finds no counterpart in other states.

This belief of the Committee is based on what it considers sound principles of tax administration and is not intended to reflect on the present executives or staffs of either department. In fact, statements before the Committee indicate a high level of cooperation on the part of responsible persons in both departments in exercising their joint responsibilities in this area. Nevertheless, few regulations have been issued with respect to taxes where the shared responsibility exists and the drafting and promulgation of such regulations would obviously be retarded by the practical, although not statutorily required, need to obtain the assent of the Auditor General.

The divided responsibility violates a basic principle of good organization. The initiative to improve procedures and practices is submerged by the need for cooperation and the possibility of conflict is always present. The generally offered justification that the divided responsibility provides a desirable "check and balance" and protects both the taxpayer and the government is not believed to be meritorious, in view of the fact that good tax administration which protects the taxpayer and the government has not elsewhere than in Pennsylvania been thought to require a share responsibility. On the contrary, the Committee believes that such shared responsibility has not been conducive to good administration and that unified responsibility and commensurate authority, with the organizational and procedural recommendations made herein, will give greater assurance of effective and equitable administration than the present shared responsibility. The

Committee, accordingly, recommended in the preceding chapter on organization and responsibility for tax administration that the approval of the Auditor General in the determination of the tax liability of a taxpayer be eliminated with respect to all taxes.

The Committee believes that it should be the object of a sound administrative procedure to assure that every taxpayer against whom a deficiency in tax is proposed to be assessed have an opportunity to confer with and present his position to the Department of Revenue and to assure that the Department be in a position following such a conference, or additional conferences if necessary, to make its final determination, which it is prepared to defend in appellate proceedings. At the present time, in the case of corporation taxes, the presettlement conference has been reinstated but taxpayers are not notified that such conference is available. Furthermore, any request by the taxpayer for such conference must be made without knowledge as to whether his tax return is to be challenged. In the case of the sales tax a taxpayer usually has an opportunity for a preassessment conference if the assessment results from a field audit. If, however, it arises from an office audit he may not have such opportunity. Except for such an uncertain opportunity for a presettlement or preassessment conference, the aggrieved taxpayer's only recourse under present procedures is to file a petition for resettlement or a petition for reassessment, which, regardless of the importance of the issue or the amount involved, is considered by the Resettlement Board or a Sales Tax Board, as the case may be. Such an

administrative procedure appears to the Committee to be unnecessarily formal in most cases, particularly with respect to the Sales Tax Boards.

The Committee believes that the term "settlement" as applied to corporation taxes is an unusual term and, although it has a long history in Pennsylvania corporate taxation, is one which is confusing to both out-of-state (the term is not used in other states) and domestic taxpayers. More appropriate and familiar terminology would have the Department "reviewing returns" and "proposing to assess deficiencies" or "assessing deficiencies." This follows the federal practice with which all business taxpayers are familiar.

THE COMMITTEE RECOMMENDS THAT —

2. The statutes be amended to establish the following procedures to be followed by the Department of Revenue when deficiencies are to be assessed under any tax:

   (a) Every taxpayer whose return is not accepted as filed shall be sent by certified or registered mail a notice of a proposed deficiency in tax by the Department stating the grounds on which the deficiency is based.

   (b) Following the issuance of a notice of a proposed deficiency a taxpayer shall have 30 days within which to file with the Department a protest stating the grounds for his disagreement with the proposed deficiency; and if within such 30 day period, or an extension of such period to which the Department consents, a protest is not filed by the taxpayer the proposed deficiency shall be promptly assessed.

   (c) At the request of a taxpayer, following the filing of a protest, a conference shall be held with the representatives of the Department for the purpose of reconciling, if possible, the positions of the Department and the taxpayer. (The nature of the conference and the level at which it is held should be left to administrative discretion, exercised in the light of the importance of the issue and subject to the discipline that, following the conference or conferences, the Department should be prepared to defend its determination in appellate proceedings if the taxpayer appeals.)

(d) The Department shall have the authority to enter into an agreement with a taxpayer establishing the taxpayer's liability for the taxable period or periods involved on a basis which is acceptable to both the Department and the taxpayer as a reasonable application of the law or evaluation of the hazards of litigation.

(e) If the liability of a taxpayer is not agreed upon after the filing of his protest and any conferences that may have been held, the Department shall send to the taxpayer by certified or registered mail a notice of deficiency stating the issues involved and the grounds for the deficiency.

(f) Following the issuance of a notice of deficiency a taxpayer shall have 90 days within which to file a petition for review with the Board of Tax Appeals (as hereinafter recommended), in accordance with rules adopted by it; and, if within such 90 days period the taxpayer does not file such a petition, the deficiency shall be promptly assessed.

Board of Finance and Revenue

The Committee has given careful consideration to the administrative and procedural problems which have been expressed with respect to the Board of Finance and Revenue. The Committee has examined the organization of the Board and its procedures and has conferred with the Executive Secretary of the Board. Findings expressed here refer entirely to the administrative structure of the Board as provided by law and by procedures which are backed by long precedent. They do not reflect in any way upon the present make-up of the Board or upon the staff employed by the Board.

The Committee believes that the ex-officio composition of the Board of Finance and Revenue of itself presents certain difficult problems. The official members are busy office holders who rarely have time to sit on the Board in person. In practice they designate members of their staff to

sit for them. This has the advantage of bringing a reasonable continuity of service and also of expertise to the affairs of the Board but does not resolve the inherent disadvantage of the ex-officio board, in that the persons serving upon it can only devote a part of their time and attention to the tax problems which the Board must hear.

Another difficulty is the fact that two of the departments represented on the Board, Revenue and Auditor General, have already participated in settlement and resettlement of corporate taxes and therefore commonly are in the position of passing judgment upon their own decisions. Complaint has often been voiced that the decisions of the Board are not accepted as establishing precedents by the Departments of Revenue and Auditor General in arriving at future tax settlements.

The findings of the Committee confirm this complaint. This situation arises in part because the Board, rather than being a unified entity in its own right, actually represents five separate departments and sometimes that many different points of view. Therefore, when the representatives of the departments who made the original settlement find themselves outvoted in decisions of the Board, they tend to view the decisions as representing opinions of other departments and not a Board opinion which they should then follow as precedent in future settlements.

Not only do the decisions of the Board fail to establish precedents, but they also fail to provide guidelines for taxpayers in future determinations of tax liability. This arises from the fact that the Board publishes only its

decisions and not the facts and conclusions upon which those decisions are based. The Committee believes that decisions of the Board would play a much more important and useful part in tax administration and that the volume of appeals in the future might be lessened if the Board published some form of opinion in which the facts and the conclusions upon which its decisions were based were made known. Despite the problems and complaints that have been expressed concerning the Board of Finance and Revenue, there appears to be common agreement that the relatively informal procedure followed by the Board in the hearing of appeals is desirable and should be continued. The Committee concurs, feeling that taxpayers representing businesses of all sizes need this final opportunity for an informal and therefore relatively inexpensive hearing of their cases before incurring the time and the expense involved in a judicial appeal.

THE COMMITTEE RECOMMENDS THAT —

3. An independent Board of Tax Appeals be established by statute as follows to hear appeals by taxpayers from determinations of tax liability by the Department of Revenue:

   (a) A Board of Tax Appeals consisting of three members serving full time shall be appointed by the Governor with the advice and consent of the Senate for nine-year staggered terms, one of the members being designated Chairman. Appointees shall have and shall have demonstrated, prior to appointment, interest in and knowledge of problems of taxation and their appointment shall be made without regard to party affiliation or interest in any special organization or group. The members shall be eligible for reappointment, but only after having completed the term for which appointed, and shall be paid salaries at the same level as those of cabinet officers or members of the Public Utility Commission. The Board's employees shall have civil service status.

(b) A taxpayer shall have the right to file a petition for review with the Board:

(i) Within 90 days after a notice of deficiency has been issued to the taxpayer by the Department.

(ii) After the expiration of six months from the filing of a protest by the taxpayer, if action has not been taken by the Department on the taxpayer's protest.

(c) A taxpayer shall elect in his petition to have the decision of the Board based either on:

(i) a verified statement of facts filed by the taxpayer, or

(ii) a record made in accordance with appropriate rules of evidence prescribed by the Board.

In a case where the taxpayer has elected to have the decision of the Board based on a verified statement of facts the Board may, on request of the taxpayer, the Department or the Board, accept additional oral or documentary evidence without regard to any formal rules of evidence.

(d) The Board shall in each case in which it renders a decision prepare and publish a written opinion containing a statement of the applicable principles of law and the reasoning by which these principles were applied to the facts to reach the decision.

(e) A taxpayer shall indicate in his petition his preference for having his case heard in Harrisburg, Philadelphia or Pittsburgh and the Board shall hold sessions in those cities as the work-load and the location of petitioners require.

(f) The Department of Revenue shall be represented before the Board by its chief counsel or his delegate.

(g) Compromises between taxpayers and the Department of cases pending before the Board shall be entered as decisions of the Board without opinion, and shall be final and not appealable as to the year or years involved.

(h) Decisions of the Board, other than by compromise, shall be subject to appeal to the Commonwealth Court by either the Department of Revenue or the taxpayer. The action before the Commonwealth Court in cases where the taxpayer elected to have the decision of the Board based on a verified statement of facts, shall be a trial de novo, but only of the issues raised before the Board, and in cases where the taxpayer elected to make a record before the Board in accordance with rules of evidence prescribed by the Board, shall be an appeal on the record.

(i) If the decision of the Board of Tax Appeals is not appealed to the Commonwealth Court it shall be a precedent binding on the Department in other cases, unless the Department secures an opinion of the Attorney General that the decision is an erroneous interpretation of the law.

Resettlements and Refunds

The Committee concurs in the complaints that have been voiced concerning the virtually unlimited authority granted the Department of Revenue under Section 1105 of the Fiscal Code to resettle corporation taxes. Although the Commonwealth should be entitled to a reconsideration of an erroneous determination, the Committee believes poor taxpayer relations and impairment of the business tax climate can result where this is exercised repeatedly on the same tax return or where resettlement is used to implement changed policies of tax administration. Resettlement and review in a well administered taxing system should not be unlimited but rather should be subject to reasonable restraint and limitation.

The Committee finds that statutory and administrative policies concerning refunds or credits for overpaid taxes are inconsistent and also burdensome to the taxpayer. Inconsistency occurs when sales taxes can

be refunded and corporation taxes cannot be, as well as when petitions for sales tax refunds can be made retroactive only for 18 months while the Commonwealth can make deficiency assessments retroactive for three years. The statutory background of these problems has already been discussed.

THE COMMITTEE RECOMMENDS THAT —

4. The statutes be amended to provide that:

   A three year statute of limitations running from the date a return is filed shall apply to the assessment of a deficiency by the Department and to the filing of a claim for refund by a taxpayer. An exception shall be provided in the case of a fraudulent return and there shall be no limitation on the assessment of a deficiency in such a case. An exception shall also be made in the case of changes made by the Federal Government in the net income as returned by a taxpayer to the Federal Government. The Department shall be authorized to enter into an agreement with a taxpayer to extend the statutory period of limitation. In the case of the granting of a refund by the Department, there shall be a two-year period from the date of payment of the refund in which the Department may bring suit in the Commonwealth Court to recover a refund erroneously made and, in the case of a deficiency there shall be a two-year period from the date of payment of such a deficiency in which the taxpayer may file a claim for refund of the tax paid.

5. The procedure with respect to a claim for refund by a taxpayer shall follow that applicable in the case of a proposed deficiency. If the Department proposes to disallow the refund in whole or in part, it shall issue a notice of proposed disallowance giving the taxpayer 30 days in which to file a protest and to request a conference with representatives of the Department. If, following the protest and any conferences, it is the Department's determination that the refund will be disallowed in whole or in part, it shall send to the taxpayer a notice of disallowance of the refund briefly stating the grounds for the disallowance in whole or in part and the taxpayer shall have 90 days thereafter in which to file a petition for review with the Board of Tax Appeals.

6. The proceedings before the Board and appeals to the Courts shall be subject to the same rules as with respect to deficiencies. Refunds allowed by the Department or determined by the Board of Tax Appeals or the Courts, together with interest, shall be paid or credited to the taxpayer at his election.

## IV

## AUDITS AND INVESTIGATIONS

The daily contact by the field operations staff of the Department of Revenue with the taxpayer makes field auditors and field investigators public relations men as well as enforcement agents for the Department. The manner in which they carry out their responsibilities, therefore, has a direct bearing upon Pennsylvania's business climate.

In view of the importance of field operations, the Committee made a detailed study of the policies and procedures followed in enforcing tax laws and in conducting field audits. The investigation was basically separated into two sections, the first dealing with the field operations of the Bureau of Corporation Taxes and the Revenue Department in general, and the second with the Sales and Use Tax Bureau field functions. Specific consideration was given to such topics as the:

1. feasibility of combined audits,
2. problems of enforcement,
3. audit of out-of-state taxpayers,
4. adequacy of communication between the central office and field personnel and of audit instructions and guides,
5. scope of authority to be granted to field auditors,
6. organization and size of audit staff,
7. personnel practices including hiring, qualifications, compensation and in-service training.

The research methods utilized by the Committee included the conducting of an audit program survey of selected corporations, and the interviewing of staff personnel of the Department of Revenue, both in the central office in Harrisburg and in the field offices.

At the outset of its study the Committee was aware of the existence of several problem areas in the field operations sphere as they had been related by business taxpayers. These problems are listed below.

## Comments and Criticisms

### A. Corporate Taxes

The authority granted auditors to make basic decisions without referral to Harrisburg is said to be too limited and works to the detriment of the taxpayer. This applies particularly to questions on capital stock valuations and the manufacturing exemptions, and places the auditors in the position of being solely issue-raisers and transmitters of information.

### B. Sales Taxes

1. Improvement seems to be needed in auditing procedures. One example frequently cited was the failure to check the validity of time periods used in sample audits.

2. It was claimed that most auditors are not accountants, are poorly informed as to the law and lack competence. It was also claimed that they are rated on volume of work, and thus tend to be arbitrary in arriving at additional assessments. Field auditors often seem to be unaware of central office rulings.

3. The Bureau of Sales and Use Tax, immediately upon completion of an audit, should be required to provide the taxpayer with copies of audit workpapers.

4. Exemption certificates which are accepted by a seller in good faith should be honored by Department auditors and the recipient not forced to go behind the certificate to prove that the sale was exempt. This constitutes performing the auditing function for the Commonwealth.

## FINDINGS AND RECOMMENDATIONS

### Bureau of Corporation Taxes

Although there are approximately 86,000 corporate tax accounts, not all are considered to be of sufficient size to justify regular audits. The current audit staff of about 18 auditors performs around 200-300 audits per year.

In recent years Pennsylvania has not performed any audits of companies whose home offices are west of the Mississippi River. Inadequate travel funds is the main reason given.

There have been relatively few taxpayer complaints concerning the audit of corporate taxes. The auditors have been uniformly rated as competent and hard-working; their deportment with corporate taxpayers was judged satisfactory. Corporate tax auditors are charged with the duty of assembling and verifying information needed by taxing officers to set valuations. The auditors have no leeway to discuss or to adjust valuations.

Corporate Tax field investigators make inspections and investigations of corporate taxpayers suspected of being in arrears, to enforce the tax laws. The full complement of field investigators is 30 and the Bureau now has 28 on the payroll. Bureau officials feel that this is spreading the investigators much too thinly across the State, but the Bureau is limited in this regard by both budgetary and organizational considerations. The Bureau feels that the investigator staff is doing as good a job as possible under the circumstances, and is of the opinion that investigators would not be more

effective if they were covered by civil service.

Neither auditors nor investigators in the Bureau of Corporation Taxes are under civil service but such coverage for all department personnel is recommended in Chapter II on departmental organization.

Pennsylvania's audit program does not currently make any use of the combined audit, i.e., a single audit of a tax account for both corporate and sales taxes made by the same auditor. Separate audits, by both bureaus, are the rule in the Commonwealth. It had been suggested to the Committee that if a field auditor could audit the same account for more than one tax while on the premises, there might be a reduction in the time required for audits — to the advantage of both the State and the taxpayer. The Committee studied the feasibility of using combined audits. It found that the great majority of taxpayers who have experienced this audit arrangement expressed opposition and that the experience of the tax departments of other states indicates combined audits are not satisfactory to either the state or the taxpayer. Among the drawbacks are the fact that it is difficult for each auditor to become expert in all taxes and the possibility that a relatively quick income tax audit may be delayed while a protracted sales tax audit is underway.

There are a large number of Capital Stock and Franchise tax returns involving a small amount of tax revenue. In the case of the Capital Stock tax the Commonwealth applies a minimum valuation of $1,000 resulting in a tax of $5.00 per return. The cost involved in processing the return

reportedly exceeds $5.00.

Incorporated bars, restaurants, hotels, etc., can transfer or sell their liquor licenses before settlement of outstanding state taxes, because present law does not permit the Liquor Control Board to hold up a transfer because of unpaid taxes. The Liquor Control Board keeps the Department of Revenue informed of prospective transfers of licenses but can take no action beyond this notification. After the license is transferred, collection of back taxes becomes extremely difficult, thus resulting in a great many delinquent accounts.

THE COMMITTEE RECOMMENDS THAT —

1. The practice whereby the Commonwealth does not perform audits of companies whose home offices are west of the Mississippi River be reviewed and such audits be undertaken when justified by comparison of potential yields with necessary costs. After a representative number of audits have been conducted a cost study should be made.

2. A program of combined audits, i.e., sales tax and corporate tax audits conducted simultaneously on the same taxpayer, not be instituted.

3. Consideration be given to amending Pennsylvania's Capital Stock and Franchise Tax Act to provide for a minimum tax (filing fee) of $25.00.

4. The Liquor Control Board be given statutory authority to delay transfers of liquor licenses until all outstanding tax liability of the original licensee is paid.

## Bureau of Sales & Use Tax

### The Audit Program

The Sales and Use Tax audit program in Pennsylvania aims at being

both educational and productive. It concentrates mainly upon auditing the larger taxpayers, both within the Commonwealth and out-of-state. The audit program is coupled with an investigatory function carried out by the Bureau's field investigator force; these men, however, are not auditors. The record of these two programs, in terms of both size and yield, is shown in the following table for the past three years:

Auditors

| | 1961 | 1962 | 1963 |
|---|---|---|---|
| Number of Auditors | 174 | 202 | 183 |
| Number of Audits | 1,288 | 2,134 | 1,295 |
| Audits per Auditor | 7.4 | 10.6 | 7.1 |
| Total Yield | $7,202,465 | $6,047,339 | $4,277,843 |
| Yield per Auditor | 41,393 | 29,937 | 23,371 |
| Yield per Audit | 5,592 | 2,834 | 3,303 |

Investigators

| | 1961 | 1962 | 1963 |
|---|---|---|---|
| Number of Investigators | 176 | 199 | 152 |
| Number of Investigations | 75,224 | 70,270 | 75,085 |
| Investigations per Investigator | 427 | 353 | 494 |
| Total Yield | $4,827,010 | $4,736,097 | $4,706,016 |
| Yield per Investigator | 27,426 | 23,799 | 30,961 |
| Yield per Investigation | 64 | 67 | 63 |

The Sales and Use tax law in Pennsylvania is relatively new, and such measures as yield per audit and per auditor have not yet stabilized. In the case of a new law, however, the trend of these yield statistics ought to be downward as far as auditing is concerned. As experience increases with the new tax, fewer and fewer "honest mistakes" and misinterpretations should occur,

thus producing a downward trend. This seems to be the case here, although yield per audit shows some fluctuation.

Field investigations in Pennsylvania have had two pertinent aspects. First, a new law requires a great many investigators to aid taxpayers in its interpretation, and second, all field investigators are politically appointed. Yield statistics for investigators are relatively steady, but total yield tends upward, if the number of investigators is also considered.

With the passage of time, the need for field investigators should decrease, and the need for auditors should increase. This seems to be reflected in Pennsylvania experience. The complement of auditors has increased by a small number, and the number of investigators has decreased by about 50.

In the early years of Pennsylvania's Sales and Use tax law, field auditors and investigators were not as skilled as could be desired. Many auditors considered themselves as merely "gatherers" of information and submitted details to the Bureau's Audit Review Section for determination as to whether or not the taxpayer was complying with the law. Many of the early audit assessments were stricken or substantially reduced because of lack of training or understanding on the part of field auditors and the audit review staff.

Today, a new auditor receives a one-week orientation in Harrisburg before being sent to the field office. During this orientation he familiarizes himself with the Bureau's forms, policies and procedures. He is given a brochure containing all the forms that he, as a new field auditor, will have

to use. During the week he is instructed in the use of these forms.

After the week's orientation he is sent to the field and the remainder of his training is on-the-job. This is a continuing process, and the new man is constantly evaluated. The chief of field operations at the Harrisburg office receives frequent reports on the new man's progress in the field. These reports come from the field division directors' offices.

The new auditor receives, as aids in his field work, a "State Procedures Manual" and a Prentice-Hall "Sales and Use Tax Service."

Audit Selection Procedures

Audit assignments are largely from the field operations headquarters in the central office. Assignments are made from selected accounts, and accounts to be audited may be selected by any of eight different methods.

1. For monthly accounts, audit selections are generally made on the basis of a statistical analysis. Tab runs are made to organize sales tax licensees by industry code, and to get average receipts, taxes paid, etc., for a number of years. Then companies are selected for audits on the basis of their deviation from the mean for their group. This method accounts for at least 80 percent of the audits made.

2. Corporate clearance requests by corporations who wish to cease doing business in the Commonwealth result in about 10 percent of the audits performed. This process is actually controlled through a central clearance unit in the Revenue Department.

3. Bankruptcies must be audited. The Bureau has bankruptcy districts located throughout the State near both the courts and the referees. An attempt is made by the Bureau to file timely claims to protect the Commonwealth's interest.

4. Chronically delinquent accounts are scrutinized for audit material.

5. Credit requests or unauthorized deductions on returns often result in some sort of audit, but this is usually limited to correspondence.

6. Audits are sometimes made on the basis of tips received by the Bureau from informants.

7. Requests for direct pay permits or formulas necessarily result in audits.

8. Finally, requests from district offices for specific audits, perhaps because of information developed on other audits, are sometimes made and granted.

Although approximately 80 percent of the audited accounts are selected on a statistical basis, the remainder are chosen in a seemingly hit-or-miss fashion. Enough cannot be said about the importance of developing a sound statistical basis for audit selection through the intensive use of electronic data processing machinery. Organized in this way, accounts will be selected on an objective basis, with a good chance that those most in need of an audit will be audited.

## Personnel Considerations

Civil Service. As of April 1964, about 28 percent of the 896 positions in the Bureau of Sales and Use Tax were covered by civil service (see Table 3). This included 204 auditors, seven accountants, 40 key punch operators, two statisticians, and a number of tabulating and machine-records people. This is contrasted with the practice in other major sales tax states, such as Michigan and California, where civil service coverage is virtually complete.

Size of Field Operations Staff. Table 4 presents a comparison of the sales and use tax audit and investigative forces in Pennsylvania and in four other industrial states. In the fiscal year 1961, Pennsylvania had approximately 182,000 sales tax accounts with 160 auditors. This was 1,135 accounts per auditor. In California there were 498 accounts per auditor, 710 in Ohio, 800 in Michigan and 1,152 in Illinois.

In April 1964, Pennsylvania had approximately 226,000 accounts with 204 auditors, or 1,108 accounts per auditor. Thus, the picture has not materially changed in three years. (1

Table 4 also shows that in 1959 the number of audits performed per auditor was substantially less in Pennsylvania than in other states. Part of this is attributable to the exemptions in the law which necessarily make Pennsylvania's audit more time consuming. It is nevertheless true, however, that output per man has not increased since 1959. As the table referred to shows, the number of audits per auditor has actually declined by one (from 8 to 7.1) in the four years from 1959 to 1963. There would seem to be an obvious need to expand the audit program and to increase the number of auditors accordingly.

Communication with Field Personnel

Sales tax administration in Pennsylvania has been decentralized into three sales tax regions, each with a regional office, and 22 sales tax

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1) It is recognized that a substantial number of accounts are not of sufficient size to justify audit. The same, however, is true for the other states included in Table 4, which means that Pennsylvania's ratio of accounts per auditor would still be high.

districts, each with an office supervised by one of the three regional offices.

Regional directors meet with their district supervisors on a quarterly basis, and field district supervisors meet monthly with their auditors. In addition, there are semi-annual meetings held with the Director of the Sales Tax Bureau. Some district supervisors also conduct audits, but this usually occurs only in the smaller offices, where the supervisor may be the only person in the district.

Policy changes, rulings, etc., are sent from the home office in Harrisburg, whenever necessary. Generally, when new matter is sent, it is received throughout the field offices within a few days.

Sales Tax Delinquency and Enforcement

Table 5 contains a summary list of delinquent sales and use tax accounts for the years 1963 and 1964. The table indicates that about 6 1/2 percent of all accounts were delinquent as of July 1, 1964. The amount of tax revenue involved was $20,177,000 — about four percent of that year's sales and use tax collections. Not all of the $20.2 million is "due and owing" or is collectible. A total of $6.1 million is on appeal, a portion of the $4.8 million in the delinquent accounts will be appealed, and $1.7 million is considered uncollectible.

During the one-year period shown in the table, the backlogs before the Sales Tax Board and the Board of Finance and Revenue, both as to number of cases and total dollar amount, have been substantially reduced. The number of court cases remained about the same although the dollar

amount increased. There was a substantial increase in the cases and tax dollars written off as uncollectible, an increase reported to be a result of more "realistic" reporting rather than real increases.

There are two basic types of delinquencies: (1) a report delinquency, i.e., when a licensee fails to submit a required tax report, and (2) a money delinquency, occuring when a taxpayer submits a return admitting a tax liability but fails to pay, or when a taxpayer has been audited and assessed but has not paid the assessment.

Report Delinquency. The Bureau of Sales and Use Tax attempts to control report-type delinquencies by preparing "delinquent decks" approximately 30 days after the due date of a given return. The delinquent decks are created by matching collection cards for processed returns against a work deck covering the same report period. The unmatched cards from the work deck make up the delinquent deck.

The delinquent decks are then divided into 22 groups, matching the areas covered by the 22 district offices. The decks are forwarded to the appropriate district office and assigned to field investigators with instructions to contact the delinquent taxpayers.

Upon receipt of a delinquent deck a field office should check the taxpayer's folder in the local office to determine whether the given taxpayer is a chronic offender. If he is, a field man would be immediately assigned to the case with specific instructions to bring the taxpayer completely up to date. It should be remembered that by the time the January delinquent

deck has been assembled and forwarded to the field office, the February tax report is about due.

The Sales and Use tax law provides a monetary penalty equal to an additional five percent of the tax due for each month the required tax report is not filed. The penalty, however, may not exceed 25 percent of the tax liability in the aggregate.

Money Delinquency. The money-type delinquency is readily identifiable and easy to calculate. This type of delinquency is categorized into various groups for collection purposes (see Table 5). For example, the same type of administrative or punitive measures should not be taken against a taxpayer with an unpaid audit deficiency as would be taken against a taxpayer with a deficiency representing monies admittedly collected but not remitted. Once again, one of the important factors is identifying those taxpayers who are chronically delinquent.

When a report comes in with a money deficiency, the Bureau assigns a special prefix to the account to make it readily identifiable, and sends out a "ten-day letter." This letter indicates to the taxpayer what is owed, and asks for immediate remittance. If no answer is received within ten days, the Bureau issues an assessment, and the taxpayer, upon receiving the assessment, has 30 days in which to remit the tax money. After the 30 days pass, a lien can be filed against the delinquent taxpayer. However, in practice it takes the Bureau anywhere from 90 to 120 days to file the lien, due mainly to the present backlog of these actions. Thus, from the

date of delinquency, the entire process takes anywhere from one to five months, and generally, this is enough time to allow the delinquent taxpayer to leave the State.

There are alternative courses of enforcement action already in the law and available by administrative action to the Bureau, but they are not being used at this time.

Existing law permits the Bureau to require a taxpayer who has on three or more occasions within a 12-month period either filed a tax return or made payment to the Bureau more than 30 days late, to file a bond. The bond may be required for a period of three years. This method would seem to be an effective way of safeguarding tax revenues in the case of chronic delinquents.

In addition, underpayment provisions in the law provide that the Bureau can issue an immediate assessment for the amount due, and can require payment of the assessment within ten days. If not paid after ten days, a lien can be filed. This method would considerably shorten the period of time now required to file a lien for the deficiency. It is not now used because of the vague chance that a taxpayer might file an appeal from the assessment.

The law also provides, in addition to the levying of various penalties and interest and the filing of liens, that any person who willfully fails or refuses to collect and report tax due, or to file a required return, may be charged with a misdemeanor and prosecuted. Upon conviction a fine not

exceeding $1,000 or imprisonment not exceeding one year, or both, shall be imposed. Finally, any person who collects and converts or misappropriates the tax may be guilty of embezzlement under Section 823 of the Penal Code.

There is no provision to empower the Bureau to padlock a business until the deficiency is paid, or to revoke the business' sales tax license, or to place a representative on the premises with instructions to sequester the proceeds of current sales until a sufficient amount is obtained to liquidate the indebtedness.

## FINDINGS AND RECOMMENDATIONS

### Bureau of Sales & Use Tax

The Committee believes there has been substantial progress in the improvement of audits. This is reflected in replies to the Committee's questionnaire survey of sales tax licenses. The tabulation of replies showed that many taxpayers who have recently undergone field audits have been impressed by the knowledge, work habits and conduct of the auditors. This is a healthy sign and the continuation of the quarterly, semi-annual, and annual meetings of the field auditors and field supervisors will help to maintain the professional qualifications of this group. The Committee commends the Bureau for the improvements of recent years.

The Committee believes that the need for field investigators lessens, and the need for auditors increases, as the Sales tax law becomes older and

is better enforced. As a consequence, it would seem desirable to reduce the number of field investigators employed by the Bureau, and to use the money thus saved to increase the audit staff. The number of field investigators has declined over the years. In 1961 there were 200 positions and there are now 152. The continuance of this trend would certainly allow for an increase in the audit staff since the salary paid three "Investigators I" would more than cover the salary of two "Auditors II" (see Table 2). Just how many field investigators and auditors are needed is a matter of judgment. A major consideration, of course, should be the amount of additional revenue produced.

Civil service coverage of field personnel remains too limited. It should be noted that many taxpayers' only contact with the State government will be via the field personnel, i.e., a sales and use tax auditor or investigator. These men, therefore, must represent the State fairly, and still create a favorable impression on the people they are auditing. The results of the Committee's survey indicate that there has been marked improvement in this connection in the past several years, but there is room for even greater strides forward. Certainly, extending civil service coverage to field investigators would help to attract the type of person that would represent the State in the most desirable manner.

Civil service for the Sales Tax Bureau's positions of Field Investigator II-III, Tax Examiner I-IV, Sales and Use Tax Administrator I-IV and Administrative Officer I-IV would introduce a degree of professionalization

into the "middle management" positions.

These findings substantiate, for this one area, the recommendation for general civil service coverage in the Department of Revenue made in Chapter II on departmental organization.

The findings made in Chapter II on departmental organization concerning relatively low starting salaries in the Department also apply to field auditors and investigators.

THE COMMITTEE RECOMMENDS THAT —

5. Improvement in the quality of audits remain a continuing goal for the Bureau of Sales and Use Tax to the end that auditors have reasonable areas for decision-making and not be simply fact-gatherers.

6. The sales tax audit force be increased so that the Commonwealth has one sales tax auditor for every 700-800 accounts. In addition, the number of audits made per sales tax auditor should be increased.

7. Consideration be given to further reduction in the field investigator force, and to placing the remainder under civil service coverage (see civil service recommendation in Chapter II on departmental organization). Any monetary savings should be used to increase the audit force. The enforcement needs of the Sales Tax Act which called for a great deal of investigatory and educational work in the early days of the tax, now call for major emphasis on a good audit program.

8. The starting salaries of field personnel employees of the Pennsylvania Department of Revenue be revised upward where found to be less than salaries paid for similar positions by other states, the Federal government and by private industry. (See salary recommendation in Chapter II on departmental organization.)

Effective sales and use tax administration in a state as large as Pennsylvania calls for decentralization. Taxpayers are numerous and widely dispersed, and it is obviously not feasible to serve them from a

single office. Although the Sales Tax Bureau has decentralized its physical plant and administration, the Committee finds that it has not decentralized its decision-making.

The Sales and Use tax law has been in effect for more than eight years and frequent staff conferences in Harrisburg should no longer be required to make decisions which should be made in the field. It is the responsibility of the central office in Harrisburg to provide definitive instructions to field personnel so that decisions can be made at the lowest practicable level. Auditors should be well versed in the law and in official policy so that they can minimize disputed areas at the time of audit, thus making decentralization effective. Care must be taken, however, to insure that any decentralization is accompanied by adequate safeguards to insure that field personnel do not over-step their areas of discretion and that uniformity in positions taken on issues is maintained. Effective home-office instructions and follow-up will assure this.

The results of the Committee's audit questionnaire have shown that in past years there has often been a lack of information flowing from the home office downward to the field offices. Auditors were relatively uninformed, and their performance suffered accordingly. All auditors need to be continually informed of current decisions of the Sales Tax Board and the Board of Finance and Revenue, if they are to perform their duties efficiently.

Steps are now being taken by the Bureau to remedy at least some of the informational deficiencies. The Bureau of Sales and Use Tax is presently in the process of reviewing all sales and use tax rules and regulations. The Bureau plans to republish them and to make them generally available to taxpayers. The Bureau is to be commended for this action. However, the mission will not be fully accomplished unless the reissued regulations are definitive in nature, are given widespread distribution to taxpayers, and are exhaustively reviewed with field auditors and investigators.

THE COMMITTEE RECOMMENDS THAT —

9. Sales and Use tax regulations be definitive in nature, given widespread distribution to licensees and exhaustively reviewed with field officers and investigators. Toward this end, the quarterly, semi-annual and annual meetings of field auditors and supervisors should be continued. Decisions concerning taxable and exempt transactions should be made immediately available to all field auditors and licensees. This includes determinations at bureau and department level, as well as decisions of the Sales Tax Board, the Board of Finance and Revenue, and the courts.

Enforcement procedures for report delinquencies are seemingly not as effective as necessary. There is a large backlog of chronic report delinquencies included in the total shown in Table 5. The present enforcement system seems to break down at the point where the delinquencies are assigned by the district offices to field investigators. Directors of field offices do not always give high priority of attention and follow-through to the activities of field investigators in their contact with taxpayers who have failed to file reports. Good practice would seem to require that field offices use personal contact, not mail, with those who fail to file the necessary

reports for two consecutive months.

Assessment deficiencies resulting from tax returns filed without remittance need to be subjected to prompt and vigorous action by the Bureau's field force. As soon as an assessment is issued on this type of delinquency a copy should go automatically to the field office with instructions to contact the taxpayer immediately and arrange for collection of the money. At present, the Bureau does not move fast enough on money delinquencies, or "non-remits," as they are called by sales tax personnel. Chronic delinquents ought to be subjected to more vigorous enforcement procedures than are now being used. Prompt action in the field could have great effect on the number of delinquencies being added to the list each month.

THE COMMITTEE RECOMMENDS THAT —

10. Directors of field offices give high priority of attention and follow-through to the activities of field investigators, particularly in their contact with delinquent taxpayers.

11. The Bureau of Sales and Use Tax make greater use of the powers of enforcement it now possesses and in addition that the Sales and Use Tax Act be amended to provide the Bureau with additional powers to collect deficiencies. Although there are several courses of action available to the Bureau at present, there is no provision to empower the Bureau to padlock a business until the deficiency is paid, or to revoke the business' sales tax license, or to place a representative on the premises with instructions to sequester the proceeds of current sales until sufficient amount is obtained to liquidate the indebtedness.

## V

## VALUATION AND ALLOCATION

The problems of tax valuation and allocation considered by the Committee relate almost entirely to the Capital Stock and Franchise taxes and to the Corporate Net Income tax. A major portion of time at the two taxpayer meetings in 1963 described in the Introduction was devoted to discussing problems in the valuation of the Capital Stock and Franchise taxes. These discussions, together with comments received from business taxpayers, have made it clear to the Committee that the discretion in valuation matters vested by the tax law in the Commonwealth and the vagueness and outright secrecy which surrounds the valuation process constitute a prime irritant to taxpayers doing business in Pennsylvania. Comments and complaints received by the Committee on this subject were both numerous and consistent.

A related problem is that of allocating to the Commonwealth its proper share of the tax liability of interstate businesses with operations in the Commonwealth. Allocation problems pertain to the Capital Stock and Franchise taxes and to the Corporate Net Income tax. This aspect of tax administration was studied by the Committee only partly because of taxpayer complaints, but more importantly because the extreme diversity of practice by the respective states has created a national problem which may result in the not too distant future either in the acceptance of uniform legislation by the respective states or in the enactment of Federal legislation. The Special Sub-committee on State Taxation of Interstate Commerce of

the House Committee on the Judiciary has had the matter under study for several years and is expected to recommend legislation to the Congress in the current session.

Following is a summary of representative comments and complaints received from business taxpayers.

## Comments and Criticisms

1. There is a lack of written opinions justifying valuations and other decisions of the Department of Revenue. When changes in tax liability result from a settlement or resettlement the taxpayer should be furnished with an explanation of the basis of the change as well as a statement of his account as it appears on the records of the Department.

2. The Capital Stock and Franchise taxes should be more self-assessing, eliminating the "roulette wheel" method of valuation. The present situation results from lack of a uniform formula for determination of values or allocation of business, making departmental decisions appear to be arbitrary. In the absence of a strict formula, some rules of administration or guidelines should be developed.

3. A study is suggested to establish a consistent pattern for determination of "value" on the Capital Stock tax.

4. Changes of policies and practices of the Department should be applied prospectively, never retroactively. Although not statutorily required to do so, the Department of Revenue should consider itself bound by its rulings, unless misrepresentation or error can be shown.

## Current Practices and Procedures

### Valuations

Under the Capital Stock and Franchise tax law ([1] a corporation must

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1) Act of June 1, 1889 (P. L. 420) as amended.

value and appraise its capital stock at its actual value in cash as it existed at the close of the year for which the report is made. The act sets forth the following factors to be considered in arriving at the value of a corporation.

1. The average price for which the stock sold during the year;

2. The price or value indicated or measured by net earnings or by the amount of profit made and either declared in dividends, expended in betterments, or carried into surplus or sinking fund;

3. The actual value indicated or measured by consideration of the intrinsic value of its tangible property and assets, and of the value of its goodwill and franchises and privileges, as indicated by the material results of their exercise taking into consideration also the amount of its indebtedness.

Certain kinds of property are exempted in arriving at this valuation, either by constitutional provisions, statute, or public policy. Significant exemptions include tangible property located outside Pennsylvania, certain kinds of investments, and that portion of the capital stock which is invested in and employed in manufacturing, processing, and research and development. Exemptions, however, are outside the immediate scope of this discussion.

In addition to the factors just listed, the courts have laid down a broad principle that any other factor which might enhance or detract from a corporation's value should be considered in the valuation of the capital stock. Thus, in administering the statute, the Department of Revenue, the Board of Finance and Revenue and the courts have made it clear that the factors contained in the law do not constitute a mathematical formula, but

rather that the exercise of considerable judgment is called for on the part of the administering department. This includes the Auditor General, whose concurrence in settlements and resettlements is required by law.

The factors and the weighting of those factors which enter into this statutory exercise of judgment remain vague and screened from public knowledge. The Department of Revenue publishes no formulae, rules or regulations, or guidelines which inform the taxpayer as to its policies and methods in valuation. The findings and conclusions underlying decisions of the Board of Finance and Revenue in valuation problems are unpublished and the decisions of the courts speak largely in very general principles.

Although there are no officially sanctioned rules, regulations or guidelines, there are unofficial sources of such information in books published by tax practitioners. From these the taxpayer may learn of such methods of valuation as the "three-way method," average three-way method" and "five-way method" which may be employed by the Department.

Allocation

Under the Corporate Net Income tax law (2 the allocation of income to Pennsylvania is determined by a three-part fraction. (The same allocation formula applies to the Franchise tax.) The first two fractions are based on the proportion of tangible personal property and on wages and salaries attributable to Pennsylvania as a percentage of the total of each

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2) Act of May 16, 1935 (P. L. 208) as re-enacted and amended by Act of April 30, 1957 (P. L. 807) and subsequently amended.

of these factors for all company business. The discussion here concerns the third fraction — that of gross receipts.

Under the law, gross receipts are assignable to Pennsylvania except where negotiated or effected on behalf of the taxpayer by agents or officers chiefly at, connected with or sent out from premises maintained by the taxpayer outside of Pennsylvania. Gross receipts from rentals and royalties and from interest and dividends are treated separately. Rentals or royalties are allocable according to the location of property or the use of patents. Dividends or interest are allocable outside Pennsylvania only if attributable to business conducted on premises maintained by the taxpayer outside the Commonwealth.

Departmental policy in implementing the law is set forth in Taxing Memorandum #16, which was issued on May 18th, 1959. This memorandum goes into some detail in illustrating the relationship between the sales agent, his base of operations and the corporation in determining allocations.

The Capital Stock and Franchise taxes present a different problem with regard to allocation. The Capital Stock tax, as a property tax applicable to domestic corporations, treats the value of capital stock as attaching to all tangible and intangible assets. Allocation is thus based on the proportion of (1) tangible assets in Pennsylvania, since tangible assets located outside the State are constitutionally exempt, and all intangible assets wherever located (with some specified exceptions), since such assets have a tax situs at the corporate domicile, to (2) the total assets of the corporation.

Under the Franchise tax Pennsylvania exacts a tax on the capital stock of foreign corporations (including intangibles) for the right to exercise the corporate franchise in Pennsylvania. The value of the foreign corporations' capital stock is allocated to Pennsylvania under the same three-factor formula, covering payrolls, property and gross receipts, as the Corporate Net Income tax.

A discrimination against domestic corporations arises by reason of the fact that all intangibles of Pennsylvania corporations are included in the valuation of their capital stock but only allocated portions of the intangibles of foreign corporations are included in the valuation of their capital stock. The difference in tax resulting from the use of the Capital Stock tax allocation and the Franchise tax allocation naturally will vary widely among corporations, but can be very substantial. This was illustrated by the announcement during the past year by Rockwell Standard Corporation that it intended to relinquish its Pennsylvania charter to reincorporate in Delaware, emphasizing the discriminatory effect of allocations under the Capital Stock tax as compared to the Franchise tax.

Formulary Direct Pay

This subject is somewhat apart from valuation and allocation but nevertheless has an important bearing upon the determination of tax liability. Under Appendix B to Sales and Use Tax Regulation 408, the Department of Revenue may, upon application, permit taxpayers to compute and remit Use tax in accordance with a "special recording procedure or

formulary method." By analysis and sampling of accounts, the taxpayer may establish a definitive method or formula whereby the Use tax liability may be ascertained without the examination of each individual transaction. Each such formula, of course, is subject to approval by the Department. Advantages to the taxpayer result from elimination of the need to review vast numbers of purchases in order to determine tax liability. The advantage to the Department arises from the fact that, after the initial audit to approve the formula, subsequent audits are simplified because the auditor needs only to screen the taxpayer's accounting procedures to insure that the approved procedures are being followed. It is reported that the number of taxpayers thus far making use of this helpful device is relatively small. However, the Committee has conferred with some industrial direct-pay-permit holders who have developed formulae for this purpose and they report that this method has been extremely helpful and can result in administrative cost savings.

## FINDINGS AND RECOMMENDATIONS

### Valuation

The Committee finds that valuing capital stock for purposes of the Capital Stock and Franchise taxes is confused by a lack of officially sanctioned rules, guidelines or formulae. Taxpayer criticism of the indefiniteness of the law with respect to valuation is widespread and the process is likened to "playing a roulette wheel." As one writer put it:

> "since valuation of capital stock is the one problem which is common to all capital stock (franchise) taxpayers in Pennsylvania, it is a sad commentary upon the Commonwealth tax system that it became and has been allowed to remain so esoteric." (3

The vagueness and lack of established standards creates problems in the relationships between taxing officers and taxpayers and tax practitioners. Although there is no knowledge of dishonesty or corruption, the fact remains that there have been rumors and that the present system of valuation does provide the means for cloaking dishonorable practices if they should exist. The very nature of the valuation process makes it difficult to allay suspicion or effectively to put the lie to rumor and this is harmful to the business tax climate of Pennsylvania. Moreover, the uncertainty of the valuation process makes it virtually impossible, at least from the taxpayer's point of view, to eliminate suspicion of discriminatory treatment, deliberate or inadvertant, even though valuations are determined by the Department in a wholly fair and impeccable manner. On these grounds the Committee believes that a major tax based on the value of capital stock as presently determined is detrimental to good tax administration. The Committee also believes that the vagueness with regard to valuation is a key problem in Pennsylvania's industrial tax climate, since new businesses considering entering the Commonwealth have difficulty in anticipating their tax burden.

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3) "A Ray of Light on Pennsylvania's Capital Stock Valuation" by Robert E. Cusick, "Taxes", November, 1962, Page 841.

When the desirability of establishing formulae or regulations or guidelines is being discussed, the point is always made that the law sets forth the factors to be considered in valuation but does not establish any weighting for those factors and that the courts consistently have held that the Department of Revenue has the responsibility to exercise its discretion in the application of these factors in a manner that will secure equity for the taxpayer. Some department personnel and tax practitioners alike believe that any firm identification of formulae either by regulation or more general guidelines would hamper the exercise of this discretion. They believe that virtually every tax case is so different from others that it must be treated separately.

However, while there are no officially sanctioned rules and regulations in the Department of Revenue with respect to valuation of capital stock, there is a certain amount of "lore" transmitted from old taxing officers to new taxing officers, and the Department uses as a taxing officers' handbook a volume entitled "State Taxation of Corporations in Pennsylvania" by James J. Mahon and Edward F. Habermehl. Moreover, "taxing memoranda" clarifying the law and establishing policies circulate within the Department. It is obvious, then, that unofficial standards and guidelines do exist.

Considerable thought has been given by the Committee to the possibility that Capital Stock and Franchise tax valuations may follow an industry pattern. In other words, in a given industry, there may be definitive ratios between valuation and net worth, valuation and capitalized earnings,

etc. However, there is a lack of any statistical studies or data available in the Department of Revenue to establish whether any such relationships exist. To make such a study would require the examination and analysis of an appropriate sampling of tax reports over a given period of time. With the cooperation of Department personnel the Committee had the opportunity to examine data from an extremely limited number of returns during the course of this study. The sampling was so limited, however, that no relationships could be established.

The Committee considered two major approaches to the problem of vagueness in capital stock tax valuation. One such approach would be the promulgation of guidelines for taxpayers illustrating to them the weighting of factors and other considerations in capital stock valuation. In large measure such guidelines would simply reflect current departmental policy, but could contain further refinement that might be deemed desirable. Such guidelines would give the taxpayer information on departmental policy that is not now available officially. Guidelines would have the advantage of preserving the existing discretion vested in the Department in attempting to apply the valuation factors in the most equitable manner. They would have the corresponding disadvantage of being relatively generalized and therefore still leaving the taxpayer uncertain as to his actual valuation and the basis therefor.

Another alternative considered by the Committee was the adoption of one or more strict mathematical formulae. This might be done either by

departmental regulation or by statutory amendment. Such formulae were established in Massachusetts by regulation in 1957 in order to reform and clarify the valuation procedures under its corporation excise tax. Massachusetts tax practitioners and officials agree that the mathematical formulae provided a more certain basis of valuation under the law as it existed until 1962. (4 Although the formulae were controversial at the time of their promulgation, they came to be accepted as the best way of administering the tax then in effect.

The Committee developed and gave serious consideration to a formula which it hoped might introduce certainty into the valuation of capital stock without significant change in state revenue from the tax and without serious disruption in the liabilities of individual taxpayers. The formula would have four factors and would permit the taxpayer each year to elect three of the factors and determine his valuation by averaging the three factors elected. The factors would be as follows:

(a) The average of the taxable year's and the previous four years' net income capitalized at ten percent;

(b) The average of the taxable year's and the previous four years' dividends capitalized at eight percent;

(c) The average net worth at the beginning and the end of the taxable year;

(d) The average of the closing market quotation of the stock of the company at the end of the last five consecutive quarters, including those quarters ending at the beginning and the end of the taxable year.

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4) In 1962 Massachusetts changed from what was essentially a capital stock tax in favor of what is the equivalent of a property tax. The 1957 regulations and the 1962 tax are described in the Appendix.

If the fourth factor is one of the factors used, the value should in no case be less than the market value of the stock. Some floor in regard to net worth might also be desirable, regardless of which three factors are used. Either the Department of Revenue or the taxpayer would have the right to depart from the formula in order to produce a more reasonable valuation. However, it would be presumed that the formula was correct and the burden of proof in support of the different value would rest upon the party seeking to make the change. It was further considered that there be a five-year transition to the new formula to provide time to study the effects of the formula and permit changes if necessary before any distorting effects of the formula had full impact.

The Committee believes that a formula such as this would offer a potential solution to the valuation problem. However, it recognizes that factual data as to the effect of the change — neccessary in order to make a firm judgment — is lacking. The Department of Revenue is undertaking a study to determine the effect of this formula on a selected sampling of business taxpayers, as well as its effect on State revenues. Following the completion of that study and a report by the Department, the Committee will issue a supplemental report containing recommendations applicable to the valuation problem.

Allocation

With regard to allocation under the Corporate Net Income tax, the Committee finds no apparent widespread dissatisfaction with the administratic

of the allocation formula currently applied. It seems to permit a certain amount of flexibility in planning of corporate organization. However, as a result of a U. S. Supreme Court decision ([5] which extended state tax jurisdiction, a special sub-committee of the Judiciary Committee of the U. S. House of Representatives has been studying the entire field of state income tax jurisdiction and its impact upon interstate commerce. The initial report of this sub-committee has now been made, pointing to the confusion, diversity and possible overlapping of state income tax jurisdiction. It is expected that the sub-committee will make recommendations for possible Congressional action during the current session. One phase of state income tax covered by the report of the sub-committee is the diversity of state allocation formulae and the possibility of allocating the same company receipts to more than one state for tax liability. Many state tax administrators feel that this will lead to a recommendation that Congress adopt a mandatory allocation formula for use by the states in allocating income where interstate commerce is involved. In order to head off such possible Congressional intervention, some state tax administrators are advocating the adoption of the "Uniform Division of Income for Tax Purposes Act" as drafted by the National Conference of Commissioners on Uniform State Taxes.

It may be questioned whether changes in the allocation formulae used with respect to several Pennsylvania taxes come within the scope of the

5) Northwestern States Portland Cement Co. v. Minnesota; Williams v. Stockham Valves & Fittings, Inc., 358 U. S. 450 (1959).

Committee's assignment, since changes in allocation formulae would effect taxpayer liabilities and possibly also the revenues. After consideration of the question, the Committee decided that the composition of allocation formulae fell within the scope of its activity, because allocation formulae were in their origin intended to serve, and still serve, administrative convenience and feasibility, and such effect as there may be on taxpayer liabilities and the revenues from any recommended changes by the Committee would be the consequence of its efforts to improve administration rather than to affect taxpayer liabilities or the revenues.

There is a parallel between the problems discussed with respect to valuation for the purposes of Capital Stock and Franchise taxes and the problems which allocation formulae were designed to solve. Prior to the adoption of allocation formulae, the allocation of income of an interstate business to the taxing state was left largely to administrative discretion and this was found unsatisfactory because of vagueness and uncertainty for taxpayers and administrative difficulty. Allocation formulae were resorted to as a means of improving the administration of the allocation of income of an interstate business. The Committee believes that improvement in allocation formulae and the avoidance of multiple taxation by reason of the diversity among states in the types of allocation formulae used is inseparably also a matter of improvement of the administration of taxes and has, therefore, addressed itself to the desirability of the adoption in Pennsylvania of the Uniform Division of Income Tax Act and to the improvemen

of the allocation formulae used for taxes other than the Corporate Net Income tax.

The chief difference between the allocation formula under the present Pennsylvania Corporate Net Income tax and the proposed uniform law is the manner in which sales or gross receipts are allocated. Under Pennsylvania law, gross receipts are assignable to Pennsylvania in general except where negotiated or effected outside the State. The proposed uniform act uses a destination basis for the assignment of sales of tangible personal property, except that sales would be assigned to Pennsylvania if shipped from Pennsylvania to a point outside the State where the taxpayer is not taxable in the state of the purchaser or where the purchaser is the Federal government.

The Committee believes that the exception noted to the destination basis is unwise. Assigning sales on an origin basis is inconsistent with the effort to promote economic growth in Pennsylvania through encouragement of new, or the expansion of existing, manufacturing and warehousing facilities in the Commonwealth. Departure in this respect from the Uniform law, by adhering to the destination basis in the circumstances covered by the exception, would not conflict with the main purpose of the Uniform law with respect to the sales factor, which is to avoid multiple inclusion by the states of the same sales in the numerators of their respective sales fractions. This would still be accomplished. Hence, enactment in Pennsylvania of the Uniform law without the exception described, would still serve the purpose of forestalling Congressional action if enough other states also enact the

Uniform law, with or without the exception.

The Committee was informed by representatives of the Department of Revenue that a change in the allocation formula to the destination basis without any exceptions would not significantly affect the revenues:

THE COMMITTEE RECOMMENDS THAT —

1. Taxing Memorandum #16 of 1959 governing the allocation of wages, salaries and gross receipts under the Corporate Net Income tax and the Franchise tax be withdrawn, and that the "Uniform Division of Income For Tax Purposes Act" as drafted by the National Conference of Commissioners on Uniform State Laws be adopted, omitting paragraph b of Section 16 of such act, and drafted in a manner that will preserve Pennsylvania's manufacturing exemption for the Franchise tax.

The Committee believes that the difference in allocation formulae previously described between the Capital Stock tax and the Franchise tax operates to the detriment of Pennsylvania-based corporations. The relatively higher tax burden resulting under the Capital Stock tax allocation can be substantial and thus make Pennsylvania a less attractive State in which to incorporate. The three-way formula applicable under the Franchise tax, if applied to the Capital Stock tax, will result in some loss of revenue to the State. However, revenue loss may result in any case — to say nothing of impairment of Pennsylvania's image — if there is any trend on the part of important Pennsylvania corporations to reincorporate in other states.

THE COMMITTEE RECOMMENDS THAT —

2. The allocation formula under the Capital Stock tax be amended to conform to the formula contained in the "Uniform Division of Income For Tax Purposes Act" as contained in the previous recommendation applicable to the Corporate Net Income tax and the Franchise tax - also drafted so as to preserve the manufacturing exemption.

Formulary Direct Pay

The Committee commends the Department of Revenue for the development of special recording procedures for formulary methods for reporting Use tax by direct pay permit holders. It notes that the number of taxpayers making use of this procedure is relatively small and feels that expansion of this number could result in substantial savings in administrative cost for taxpayers and Commonwealth alike.

THE COMMITTEE RECOMMENDS THAT —

3. The Department give more publicity to the formulary procedures for direct pay permit holders.

4. That the Department of Revenue explore ways and means of extending the formulary method (such as by industry guidelines) so that it can be used by more taxpayers, both large and small, without undue expense in establishing the formula.

## VI

## COMMUNICATION BETWEEN STATE AND TAXPAYER

The concern of the majority of taxpayers with tax administration, particularly those representing smaller businesses, is likely to begin and end with the communications which they receive from the various bureaus of the Department of Revenue. Printed communications such as rules and regulations, tax forms and instructions, statistical reports, represent a primary link between the taxpayer and the Commonwealth. The State's tax image thus depends to a large extent upon the quality and the quantity of these communications.

The Committee carefully reviewed the Department of Revenue's procedures pertaining to communications between the State and the taxpayer. To do this the Committee subdivided the topic into three distinct areas of investigation:

1. Adequacy of General Information to Taxpayers
2. Tax Forms and Returns
3. Accounting for Returns, Collections and Delinquencies

### Comments and Criticisms

The Committee received from corporate taxpayers a number of comments and complaints concerning various aspects of communication. These are summarized below:

Adequacy of Information to Taxpayers

1. Generally, it is claimed that there is a lack of printed regulations, and that policies and rulings are not disseminated to taxpayers. The Commonwealth should have a system for issuing interpretive regulations concerning all tax matters. (These could be similar to those issued by the Federal government.) The administration of taxes could relate to established precedent through coordinating rulings and interpretations of the Department of Revenue, Board of Finance and Revenue decisions, and accepted court decisions. It is also suggested that a regulation and rulings section be established through which the Department could issue rulings at the request of taxpayers and promulgate regulations. Rules of Procedure for Petitions for Resettlement and Petitions for Review, prepared and distributed by the Department of Revenue and the Board of Finance and Revenue, respectively, should be revised and should distinguish between rules that are mandatory and those that are suggestive only. They should be published in an up-to-date form in the tax services, and the appropriate set of rules might be mailed with a taxpayer's notice of settlement or resettlement.

2. Sales tax regulations, rulings and opinions are said to be difficult to obtain and slow to arrive. Rules and regulations should be issued in a consolidated form.

Tax Forms and Returns

1. Improved instructions are said to be needed for the preparation of returns.

2. The present three-page-wide report for corporation taxes seems to be too cumbersome, and requires a special-carriage typewriter. The Department ruling prohibiting the splitting of the pages into separate sections imposes a burden on people who do not have such equipment. The form could be changed to separate sheets which could be bound at the top. For those schedules which are presently spread over two pages, consideration should be given to running them sideways on the length of a single page. In cases of schedules which are also reported to the Federal government, it is suggested that typed copies, a photocopy, or a multilith copy of the actual schedule from the Federal return be included in lieu of the schedule now required. It is noted that reproduced forms are not now permitted.

## FINDINGS AND RECOMMENDATIONS

### Adequacy of General Information to Taxpayers

The topic of general information to taxpayers is sufficiently complicated to warrant being treated in two parts, the first dealing only with the Corporation Tax Bureau and the second with the Sales Tax Bureau.

Corporation Taxes. There is at present no Corporation Tax Bureau procedure to clarify and publish regulations concerning taxing policy, and there is no procedure to work rulings up to the regulations level as there is, for instance, in the Federal government. A relatively few regulations have been issued sporadically over a period of years and these are lacking in continuity owing to changes in policy by succeeding administrations. The complete lack of regulations governing the valuation of the Capital Stock and Franchise taxes is discussed in the chapter on Tax Valuation and Allocation. There is no provision for receiving comments on contemplated regulations. There is no mailing list that could be used to distribute informational material in the event such material was to be published. General policy coming down from the Board of Finance and Revenue is given to the Bureau's taxing officers, but is not disseminated to the taxpaying public. There are no Bureau personnel directly charged with the function of drafting rules, regulations, and instructional materials.

The Committee finds lacking in the Bureau most of the elements that should comprise an adequate program of taxpayer information.

Sales Tax. The Sales and Use Tax Bureau has operated for over eight

years without publishing and making available to the taxpayers a current official manual or digest of its rulings and regulations. (A "tentative" manual was published in 1956 when the sales tax was a selective tax. None has been issued since.) Hence, for all this time the public has been dependent upon information obtained from one of the commercial loose-leaf published services, or from separate copies of particular regulations which could be obtained only upon written request to the Bureau headquarters in Harrisburg. These were not available through any of the branch or local offices. This paucity of information is particularly difficult to understand since most other states do publish manuals of regulations. The states of Ohio, Rhode Island, Maryland, California and Louisiana have excellent publications of this type.

The Sales Tax Bureau is, however, taking steps to correct this deficiency, at least in part, and the Committee commends this action. The Bureau is in the process of writing a complete set of regulations for the Sales Tax law. These regulations will include all previously issued rules and regulations, in addition to some new material in those areas where regulations have never been issued.

The Sales Tax law has been implemented through a great many rulings, and a number of verbose regulations. The present aim is to simplify these regulations so that anyone can read and understand them. An attempt is also being made to incorporate as many rulings as possible into the new regulations, and to categorize and combine the remaining rulings. All

rulings are not being incorporated because some rulings refer only to one specific industry or phase of operations. As this type of ruling becomes generally known to the industry, it can be eliminated. The Bureau would like to have no more than 50 or 60 rulings when the job is completed.

The forthcoming regulations will alleviate a great need, but the successful operation of a retail sales tax requires that adequate information be available to vendors, and that a procedure be established to disseminate this information and to answer any questions that arise. Such a procedure is non-existent in the Sales Tax Bureau. Even the Bureau's internal regulations sometimes do not filter down to the field offices with the result that the taxpayer must often go to Harrisburg to get information or answers to questions. Since vendors are essentially tax collectors for the State, the Commonwealth would seem to be obliged to make complete information available. No matter how carefully the regulations and rulings are developed, numerous questions of interpretation will arise, and there is currently no satisfactory mechanism for answering them.

General. At present the Department of Revenue has no regular statistical publication giving data on tax collections, revenue sources, and the like. Most states provide a great deal more statistical information than does Pennsylvania. Michigan and New York are especially cited here. Publication of summaries and analyses of all aspects of tax collections would aid the Commonwealth and the taxpayer alike in future planning.

Both the Federal government and a number of states find helpful a continuing advisory committee of tax experts which meets regularly with the chief tax administrator. Such a committee provides a vehicle for bringing problems to the attention of the administrator as well as a sounding board on which to test proposed changes in regulations, procedures or forms. Such a committee could serve a useful purpose in Pennsylvania.

Finally, the Board of Finance and Revenue does not make public any of its rulings which effect taxing policy, ostensibly because of a provision in the Fiscal Code which forbids publication of taxpayer identities in connection with their cases.

The Committee reiterates its recommendation in Chapter III that a statutory obligation to issue rules and regulations be imposed on the Secretary of Revenue. In addition,

THE COMMITTEE RECOMMENDS THAT —

1. The regulations be printed and maintained in current form for public distribution.

2. In connection with the redrafting of a complete set of regulations for the Sales tax act, now underway,

   a. The regulations be definitive;

   b. The regulations be printed and maintained in current form for public distribution;

   c. The Bureau include an announcement of the availability of the regulations and an order blank in its next mailing of tax forms, in order to effect the best possible primary distribution.

3. The Department of Revenue provide pamphlets dealing with specific corporation taxes, or with specific groups of taxpayers. The pamphlets should contain the law and regulations of the taxes to which the industry or class of taxpayer would be subjected.

4. The Secretary of Revenue establish an advisory committee composed of business tax experts, the membership of which shall change periodically, to meet with him at least quarterly for consultation on problems of tax administration, and proposed changes in regulations, procedures or forms.

Tax Forms and Returns

Corporation Taxes. At present the most ponderous and confusing corporate tax form in use in Pennsylvania is the combined "Franchise, Loans, and Corporate Net Income Tax Report for Foreign Corporations" and the same form, but with the Capital Stock tax substituted for the Franchise tax, for domestic corporations. The form does not fit any normal typewriter, and even in a special carriage machine it is not easily typed, since the lines and spaces are not specifically placed for typing. The combined form was developed a number of years ago in order that the same corporate fiscal data used in computing two or more taxes need not be duplicated on that many different tax returns by each company. The achieving of this desirable objective now seems to have created other problems.

Pennsylvania has no short form for the use of Corporate Net Income taxpayers who have no need for applying the allocation of income formula. New York, Ohio and Texas now use such a short form. In addition, the Corporate Net Income tax form requires a great deal of detailed information about income. Since the legal basis of the tax is Federal taxable income as shown on Federal Form 1120, it would seem that there is no need to

show any of the computations used in arriving at Federal taxable income. A simple statement of the Federal taxable income should suffice, and if detail is needed a copy of the Federal tax return should be required as an attachment.

The Capital Stock tax return is currently complicated by the need to file exemptions and supporting schedules. Thorough study here should provide a simple,basic, typewriter size form for all taxpayers, and a series of supplements to be attached to the basic form for the use of those filing for exemptions, etc.

Finally, the section on the tax return forms which is used to show the settlement seems to be extraneous. It is not information which the taxpayer uses, and therefore, could possibly be eliminated in the interest of shortening and simplifying the forms.

As a matter of good practice, the Committee feels that all tax return forms ought to be accompanied by adequate instructions, either printed on the return form, or printed separately and supplied with the form. Instructions are totally inadequate at present.

At the conclusion of its examination of the corporate tax return forms now in use in Pennsylvania, the Committee agreed that these forms present a formidable obstacle to the average businessman. Obviously, detailed study and form analysis is necessary on a continuing basis, if the forms now in use are to be improved significantly.

THE COMMITTEE RECOMMENDS THAT —

5. The Department of Revenue review all corporate tax forms with a view toward simplification and clarification, based on the considerations stated below, and that the Secretary of Revenue appoint an ad hoc advisory committee to assist in this review.

   a. Consideration be given to eliminating from the corporate net income tax form all detail presently required in determining net income and requiring merely taxable income as reported to the Federal government.

   b. Consideration be given to having a short form for the Corporate Net Income tax for use by those taxpayers who are operating entirely within the Commonwealth and, therefore, have no allocation to be considered.

   c. Consideration be given to simple forms dealing with valuation which could be used by those taxpayers who are not eligible for allocation of the base or the exemptions under the Capital Stock and Franchise taxes, to which could be attached a series of supplements which would give the necessary information for claiming allocations and exemptions.

   d. Consideration be given to eliminating that portion of the tax form covering settlement.

   e. Consideration be given to having corporate taxes reported on separate returns if the above cannot accomplish a significant simplification and abbreviation of the present combined form.

6. The Bureau of Corporation Taxes prepare a complete and current set of instructions to accompany each tax return to guide taxpayers in their preparation.

<u>Accounting for Returns, Collections and Delinquencies</u>

<u>General</u>. The nature of the Commonwealth's tax accounting system makes necessary a thorough study before meaningful procedural changes can be suggested. This Committee had neither the time nor the resources

to undertake such a study, and so found itself limited to a rather superficial examination of the current State practices in this area. The investigation concerned, therefore, only the more obvious deficiencies of the accounting procedures now in use.

One of the most serious problems in the Bureau of Corporation Taxes is the present practice of maintaining account records for taxpayers on an individual type-of-tax basis. The system requires that each individual tax liability be paired with the payments thereon. All differences must be maintained until cleared by taxpayer action. In addition, it is not a practice of the Bureau to advise taxpayers about tax credits available except upon special written request by the taxpayer. There is need for the development of a unified system that will result in a single net ledger balance for each taxpayer which will reflect all corporate tax liabilities and payments.

In passing, the Committee noted with interest that proposed automatic data processing systems were presented by both the Corporation and Sales Tax Bureaus to a Governor-appointed committee of experts constituted to investigate the feasibility of such systems for tax accounting purposes. This Committee gave its approval to the proposals, and has recommended that the bureaus acquire A. D. P. systems as soon as available funds make it possible for them to do so. The Committee endorses the proposed installation of such systems.

THE COMMITTEE RECOMMENDS THAT —

7. Some unified basis of accounting be developed by the Department of Revenue which will result in a single net ledger balance for each taxpayer. This ledger should reflect all corporate tax liabilities and payments administered by the Bureau of Corporation Taxes.

8. Each taxpayer be furnished an annual statement of his account balances.

## VII

## ALTERNATE RECOMMENDATIONS

The prospectus upon which the Governor based his call for this study by the Committee on Tax Administration emphasized his desire for recommendations which could be implemented under his executive powers.

The recommendations contained in the preceding chapters represent, in the considered judgment of the Committee, the best organization and procedures for tax administration in Pennsylvania. Many of the recommendations can be implemented by administrative action. Others will require statutory amendment. In view of the mandate given it and recognizing the uncertainties of the legislative process, the Committee feels obligated, with respect to recommendations requiring statutory implementation, to suggest alternate courses of action that could be accomplished administratively where possible. The Committee is hopeful that such alternate recommendations would also result in improvements in tax administration but does not believe they would be as effective as the original recommendations. The alternates should not be considered unless the primary recommendations fail to receive statutory implementation.

### Organization and Responsibility for Tax Administration

Most of the recommendations for reorganization of the Department of Revenue can be accomplished administratively but there are exceptions.

The recommendation to divest the Department of all its non-tax functions, that is, motor vehicles and operators registration, traffic safety, institutional reimbursements and miscellaneous licenses and fees, would

require amending acts. If such legislation is not enacted the Committee believes that the best alternate course of action would be a strict separation within the Department of its tax and non-tax responsibilities. One way of accomplishing this would be to establish a third Deputy Secretary, to whom would be delegated the full responsibility for all non-tax functions. This should make it easier for the Secretary and the Executive Deputy Secretary to devote adequate time and attention to problems of tax administration. Admittedly, it would have the drawback of merging some unlike functions under a single deputy. However, if this action were taken it would become easier at any future time to implement a statutory amendment separating these functions from the Department.

At the present time the Attorney General has the authority to appoint deputies to provide legal counsel to,and to approve rules and regulations issued by,the various departments. Therefore,the recommendation that the chief legal counsel to the Department of Revenue be appointed by the Attorney General on the recommendation of the Secretary of Revenue and delegation of authority to him to approve rules and regulations would perhaps require amendment of the law. However, since both Departments are within the Governor's official family, a lack of legislative action should not prevent the implementation of the Committee recommendation on an informal basis pending any needed legislative changes.

Recommendation #3 calling for civil service coverage for most of the Department of Revenue staff, would require statutory change. Should this

not occur, the Committee suggests the Governor consider securing such extension of coverage by Executive Board action. Recommendation #5 can be implemented only by statutory amendment and the Committee has no alternative suggestions.

Administrative and Appeals Procedures

Recommendation #1 in this chapter calls for a statutory obligation to be imposed on the Secretary of Revenue to promulgate rules and regulations. While this is preferred, in the absence of legislative action, such responsibility can be imposed and the remainder of the recommendations can be implemented by executive action.

Recommendation #2 establishing a new tax assessment and departmental appeals procedure would require statutory amendment. In the absence of legislative action the Committee believes that there are certain improvements which the Department of Revenue could make in existing procedures.

1. The Department should make a general announcement that a presettlement conference on corporation taxes is available to those taxpayers who desire it. The presettlement conference is now in effect but this is not generally known. General availability of this device would provide the taxpayer with the opportunity for an informal conference before his tax liability has been finally determined.

2. The taxpayer should be fully informed of his rights and of necessary procedures for conferences with the Department and for initiating subsequent appeals. This includes both settlement and resettlements.

Recommendation #3 establishing a new Board of Tax Appeals would require statutory amendment. Here again, the Committee believes that there are improvements that could be made in existing procedures, pending the enactment of its recommendation.

1. The Board of Finance and Revenue should furnish the taxpayer with information on the basis for its decision in his case.

2. The Board should make general publication of tax policies which arise from its decisions. This would have to be done in a manner that would not violate the legal requirement that tax information be kept confidential.

3. The Board should consider meeting from time to time in other major cities of the Commonwealth as a convenience to taxpayers.

4. The Department of Revenue should agree to accept Board decisions as establishing precedent unless it obtains an opinion from the Attorney General that such decisions are not in accordance with the law.

5. Representatives of the Departments of Revenue and the Auditor General sitting on the Board should be different from those who may have participated in a case at the departmental level.

Recommendation #4 that would impose a three year statute of limitations on the right of the Department to resettle tax cases would require amendment of the law. In the absence of such amendment the Committee suggests that the exercise of restraint by the Department in its use of appeal rights under Section 1105 of the Fiscal Code would be desirable. The Department either could limit itself to only one resettlement per case or, better still, comply with the intent of the Committee recommendation and by its

own announced action agree to observe a three-year statute of limitation beyond which it would not resettle.

Recommendation #5 concerning refunds is of a statutory nature. In the absence of legislative action, the establishment of a unified ledger to show each taxpayer's tax status as recommended in the chapter on Communications would be of considerable assistance. The Department should also explore possibilities for making easier the transfer of tax credits among business taxpayers.

The remainder of the Committee's recommendations (Chapters IV, V and VI) either do not require legislative action or the Committee has no alternative to suggest to the legislative action recommended or no further alternative to that already suggested at the appropriate place in this report.

# APPENDIX

TABLE 2

MINIMUM AND MAXIMUM SALARIES

Selected Classes of State Employes
Pennsylvania and Other States

Field Investigator I

This is field work in making investigations and inspections to enforce compliance with state laws and regulations.

| State | Minimum Annual Salary | State | Maximum Annual Salary |
|---|---|---|---|
| California | $6,120 | California | $7,428 |
| Michigan | 5,742 | Michigan | 7,224 |
| New Jersey | 4,988 | New Jersey | 6,482 |
| Maryland | 4,540 | Maryland | 5,677 |
| Minnesota | 4,440 | Minnesota | 5,400 |
| PENNSYLVANIA | 3,925 | PENNSYLVANIA | 5,268 |
| Illinois | 3,660 | Illinois | 4,740 |
| Average Minimum Salary | $4,801 | Average Maximum Salary | $6,031 |

Management Trainee

This is introductory government work in receiving training and developing technical skills in one or more of the areas of personnel management, management methods, budget administration, program analysis, statistics, or related areas of public administration.

| State | Minimum Annual Salary | State | Maximum Annual Salary |
|---|---|---|---|
| Michigan | $6,013 | California | $6,432 |
| California | 5,832 | PENNSYLVANIA | 6,090 |
| New York | 5,500 | Ohio | 6,000 |
| Ohio | 5,040 | Connecticut | 5,780 |
| PENNSYLVANIA | 5,007 | New York | 5,500 |
| Maryland | 5,000 | | |
| Connecticut | 4,680 | | |
| Average Minimum Salary | $5,296 | Average Maximum Salary | $5,960 |

TABLE 2 (Cont'd.)

Field Auditor I

| ;ate | Minimum Annual Salary | State | Maximum Annual Salary |
|---|---|---|---|
| ıchigan | $5,742 | Michigan | $6,890 |
| ›w Jersey | 5,486 | New Jersey | 6,482 |
| ENNSYLVANIA | 4,773 | PENNSYLVANIA | 6,390 |
| ›w York | 4,720 | New York | 5,815 |
| 'erage Minimum Salary | $5,180 | Average Maximum Salary | $6,394 |

NOTE: New York and New Jersey require college graduation with major in accounting while Michigan requires either 3 years of auditing experience and high school or college graduation. BLS data reveal that work typically requires a bachelors degree in accounting or equivalent experience and education combined.

* * *

Comparative salary data obtained from BLS National Survey of Professional, Administrative, Technical and Clerical Classes also might be of interest.

| | 1st Quartile | 3rd Quartile | Mean |
|---|---|---|---|
| rivate Industry | $5,016 | $6,060 | $5,544 |

| | Minimum Annual | Maximum Annual |
|---|---|---|
| .S. Government GS-5 | $4,690 | $6,130 |
| | * 5,000 | 6,485 |
| ?roposed Salary Range | | |

Administrative Officer I

This is general administrative work directing a combination of staff services in a small department, such as personnel, management methods, and budget preparation or a small line operation such as an inspectional program.

| tate | Minimum Annual Salary | State | Maximum Annual Salary |
|---|---|---|---|
| alifornia | $9,948 | California | $12,096 |
| ew York | 7,350 | New York | 8,895 |
| linois | 7,020 | PENNSYLVANIA | 8,580 |
| onnecticut | 6,400 | Illinois | 8,520 |

| State | Minimum Annual Salary | State | Maximum Annual Salary |
|---|---|---|---|
| PENNSYLVANIA | 6,390 | Connecticut | 8,400 |
| Minnesota | 5,844 | Michigan | 7,224 |
| Ohio | 5,760 | Minnesota | 7,104 |
| Michigan | 5,742 | Ohio | 6,900 |
| Average Minimum Salary | $6,807 | Average Maximum Salary | $8,465 |

Corporation Tax Examiner I

This is technical work in the auditing of accounting records of domestic and foreign corporations to determine tax liability in accordance with the State corporation tax laws.

| State | Minimum Annual Salary | State | Maximum Annual Salary |
|---|---|---|---|
| California | $7,800 | California | $9,480 |
| Minnesota | 6,312 | Michigan | 7,914 |
| Michigan | 6,243 | Minnesota | 7,692 |
| New York | 5,910 | New York | 7,205 |
| PENNSYLVANIA | 5,268 | PENNSYLVANIA | 7,055 |
| Connecticut | 5,040 | Connecticut | 6,680 |
| Ohio | 5,040 | New Jersey | 6,482 |
| New Jersey | 4,988 | Ohio | 6,000 |
| Average Minimum Salary | $5,825 | Average Maximum Salary | $7,314 |

Corporation Tax Officer II

This is difficult technical and supervisory work in the examination and analysis of corporation tax reports to determine tax liability.

| State | Minimum Annual Salary | State | Maximum Annual Salary |
|---|---|---|---|
| California | $9,480 | California | $11,520 |
| New Jersey | 7,369 | New Jersey | 9,577 |
| New York | 6,960 | PENNSYLVANIA | 9,011 |
| Michigan | 6,849 | Michigan | 8,749 |
| Connecticut | 6,720 | Connecticut | 8,720 |
| PENNSYLVANIA | 6,716 | New York | 8,435 |
| Maryland | 6,280 | Maryland | 7,849 |
| Ohio | 6,000 | Ohio | 7,200 |
| Average Minimum Salary | $7,047 | Average Maximum Salary | $8,883 |

TABLE 3

COMMONWEALTH OF PENNSYLVANIA
Employes of Bureau of Sales and Use Tax
Showing
Class Title, Number and Annual Minimum and Maximum Salaries

April 22, 1964

| Class Title | Number of Positions | Annual Salary Minimum | Annual Salary Maximum |
|---|---|---|---|
| Messenger | 5 | $ 2,791 | $ 3,560 |
| Clerk I | 109 | 2,791 | 3,560 |
| Clerk II | 26 | 3,390 | 4,329 |
| Clerk III | 20 | 4,121 | 5,268 |
| Clerk IV | 5 | 4,551 | 6,090 |
| Clerk V | 2 | 5,529 | 7,407 |
| Clerk Typist I | 83 | 2,934 | 3,742 |
| Clerk Typist II | 21 | 3,390 | 4,329 |
| Clerk Stenographer I | 12 | 3,234 | 3,925 |
| Clerk Stenographer II | 41 | 3,560 | 4,551 |
| Clerk Stenographer III | 2 | 4,121 | 5,268 |
| Hearing Stenographer | 1 | 4,551 | 6,090 |
| *Bookkeeping Machine Operator | 12 | 3,390 | 4,329 |
| *Key Punch Operator | 12 | 3,234 | 4,121 |
| *Key Punch Supervisor | 1 | 3,925 | 5,268 |
| *Tabulating Machine Assistant | 1 | 2,791 | 3,742 |
| *Tabulating Machine Operator I | 7 | 3,560 | 4,773 |
| *Tabulating Machine Operator II | 3 | 4,121 | 5,529 |
| *Tabulating Machine Supervisor I | 1 | 4,773 | 6,390 |
| *Machine Records Executive I | 1 | 6,390 | 8,580 |
| *Machine Records Executive II | 1 | 7,055 | 9,454 |
| *Tabulating Equipment Technician II | 1 | 5,529 | 7,055 |
| Stock Clerk I | 1 | 2,791 | 3,560 |
| *Accountant II | 2 | 5,529 | 7,407 |
| *Accountant III | 5 | 6,716 | 9,011 |
| *Field Auditor I | 39 | 4,773 | 6,390 |
| *Field Auditor II | 88 | 5,529 | 7,407 |
| *Field Auditor III | 59 | 6,716 | 8,580 |
| *Field Auditor IV | 17 | 7,055 | 9,454 |
| *Field Auditor V | 1 | 8,163 | 10,954 |

TABLE 3 (Concl'd.)

| Class Title | Number of Positions | Annual Salary Minimum | Annual Salary Maximum |
|---|---|---|---|
| Tax Examiner I | 59 | $ 3,925 | $ 5,268 |
| Tax Examiner II | 28 | 4,329 | 5,803 |
| Tax Examiner III | 9 | 5,007 | 6,716 |
| Tax Examiner IV | 2 | 5,803 | 7,772 |
| Sales & Use Tax Administrator I | 9 | 6,390 | 8,580 |
| Sales & Use Tax Administrator II | 10 | 7,055 | 9,454 |
| Sales & Use Tax Administrator III | 5 | 8,163 | 10,954 |
| Sales & Use Tax Administrator IV | 4 | 9,011 | 12,075 |
| Sales & Use Tax Administrator V (Deputy Director) | 1 | 10,432 | 13,979 |
| Sales & Use Tax Director | 1 | 11,501 | 15,387 |
| *Statistician II | 1 | 6,090 | 7,772 |
| *Statistician III | 1 | 7,055 | 9,011 |
| Legal Assistant III | 1 | 5,529 | 7,407 |
| Law Clerk | 1 | 5,268 | 6,390 |
| Attorney I | 2 | 6,390 | 8,163 |
| Attorney II | 6 | 7,772 | 9,923 |
| Attorney III | 3 | 9,454 | 12,075 |
| Attorney IV | 1 | 11,501 | 14,657 |
| Attorney V | 1 | 13,979 | 17,839 |
| Attorney Examiner I | 7 | 5,803 | 7,772 |
| Sales & Use Tax Hearing Examiner I | 3 | 5,529 | 7,407 |
| Sales & Use Tax Hearing Examiner II | 2 | 6,390 | 8,580 |
| Administrative Officer I | 4 | 6,390 | 8,580 |
| Administrative Officer II | 2 | 7,772 | 10,432 |
| Administrative Officer III | 1 | 9,454 | 12,675 |
| Administrative Officer IV | 1 | 10,432 | 13,979 |
| Field Investigator I | 118 | 3,925 | 5,268 |
| Field Investigator II | 23 | 4,551 | 6,090 |
| Field Investigator III | 9 | 5,803 | 7,772 |
| Copying Machine Operator II | 1 | 3,390 | 4,551 |
| Duplicating Machine Operator II | 1 | 3,390 | 4,551 |
| TOTAL | 896 | | |

Source: Bureau of Personnel, Office of Administration
Commonwealth of Pennsylvania, 1964

*Covered by Civil Service

TABLE 4

COMPARISONS OF AUDITING AND INVESTIGATIVE FORCES, SELECTED STATES
1961

| State | Sales and Use Tax Revenue (a | | | No. of Auditors | No. of Investi-gators | No. of Sales Tax Accounts | Civil Service Status of Auditors & Investigators | Auditor | No. of Audits per Auditor Per Year (i |
|---|---|---|---|---|---|---|---|---|---|
| | 1961 (000) | 1962 (000) | 1963 (000) | | | | | | |
| Ohio | $254,291 | $262,840 | $277,459 | -------321------- | | 206,741 (e | All | 710 | 18 |
| Michigan | 390,127 | 460,497 | 499,884 | -------285 (c------- | | 228,000 (est.) | All | 800 (g | 15 |
| Illinois | 383,957 | 466,430 | 545,076 | 118 | 192 | 241,184 | Aud. Insp. Superv. | 1,152 | 17 |
| California | 714,897 | 755,122 | 813,310 | 750 | 330 | 327,509 | All | 498 (h | 44 |
| PENNSYLVANIA | 386,934 | (b 418,549 | 397,770 | 160 (d | 200 (d | 181,600 (f (est.) | Aud. | 1,135 | 8 |

a) Bureau of the Census, Detail of State Tax Collections in 1961, 62 and 63.
b) Represents 13 months collections.
c) 90 to 95 are high-level auditors. On the basis of allocation of time to sales taxes and other taxes, and to audit and enforcement (investigation) work, the number of sales tax auditors is the equivalent of about 150. By 1963 the total had increased to 293, but the proportions have remained about the same.
d) The current figures (as of 4/22/64) for Pennsylvania are 150 Investigators and 204 Auditors.
e) Number of vendors.
f) As of December 31, 1963, Pennsylvania had 225,648 tax return accounts on record.
g) Based on allocation of field examiner time.
h) Total business tax accounts, including sales tax accounts, divided by number of auditors for business taxes.
i) For the year 1959.

Source: Pennsylvania Economy League, and Due, John F., State Sales Tax Administration, Chicago: Public Administration Service, 1963.

TABLE 5

COMMONWEALTH OF PENNSYLVANIA

Bureau of Sales and Use Tax: Delinquent Accounts Summary

| Status of Delinquent Account | As of July 1, 1963 No. of Cases (a | No. of Accounts | Balance | As of July 1, 1964 No. of Cases (a | No. of Accounts | Balance |
|---|---|---|---|---|---|---|
| Delinquent Accounts Section | 3,425 | 2,978 | $ 4,106,694.30 | 5,240 | 4,702 | $ 4,758,526.17 (b |
| Sales Tax Board | 606 | 560 | 5,447,955.11 | 473 | 442 | 4,003,338.50 |
| Board of Finance & Revenue | 170 | 143 | 1,355,589.86 | 115 | 107 | 654,501.67 |
| Court Cases | 57 | 55 | 505,069.62 | 54 | 53 | 1,400,721.88 |
| Liens | 11,381 | 6,194 | 4,327,035.69 | 11,685 | 6,518 | 4,135,485.16 |
| Bankruptcy or Receivership | 2,036 | 1,143 | 2,914,238.55 | 2,307 | 1,308 | 3,142,201.37 |
| Liens on Def. Pay. Over $300 | 957 | 516 | 382,915.31 | 1,138 | 657 | 356,604.99 |
| Deferred Payments Under $300 | 306 | 261 | 80,816.56 | 260 | 238 | 62,337.92 |
| Liability Cases Under $25 | 654 | 618 | 8,480.65 | 607 | 575 | 7,550.49 |
| Sub Total | 19,592 | 12,468 | $19,128,795.65 | 21,879 | 14,600 | $18,521,268.15 |
| Uncollectible | 184 | 89 | 137,404.70 | 1,321 | 744 | 1,656,215.95 |
| Total | 19,776 | 12,557 | $19,266,200.35 | 23,200 | 15,344 | $20,177,484.10 |

Source: Bureau of Sales and Use Tax, Commonwealth of Pennsylvania

a) A Taxpayer account often is involved in more than one delinquency case (e.g., delinquencies for successive years) thus the number of cases exceeds the number of accounts.

b) Increase due to extensive reviewing of all taxpayers' files and issuing assessments for all open periods, according to the Bureau.

Exhibit A

## MASSACHUSETTS VALUATION FORMULAE

In 1957 the Massachusetts Department of Corporations and Taxation departed from a system which left capital stock valuation largely to the personal judgment of the Commissioner, and adopted Corporation Excise Ruling 1957-2. This Ruling set up a number of well-defined formulae for the valuation of the capital stock of different types of corporations.

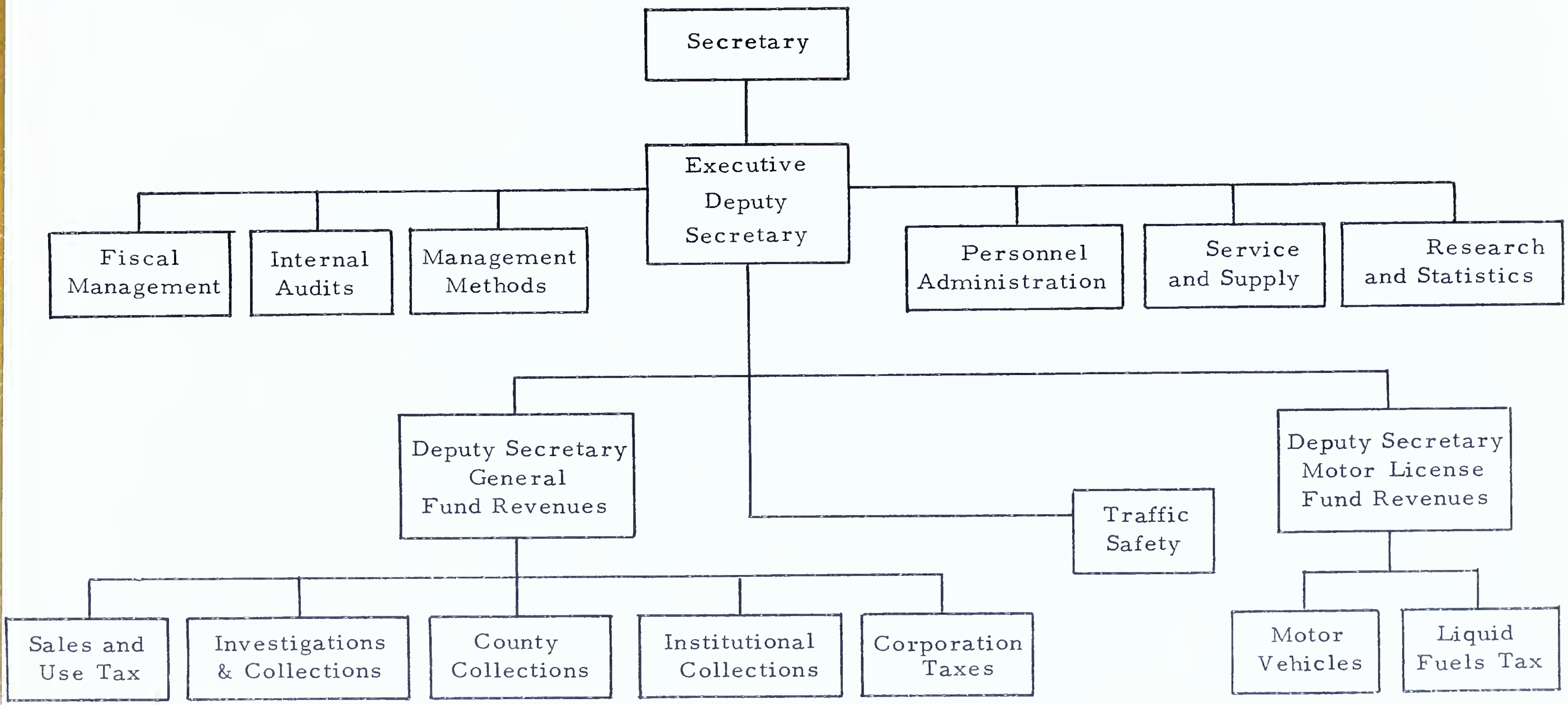
For example, the capital stock of a corporation actively traded was valued by (a) multiplying net asset book value by three; (b) multiplying average earnings for the last five years capitalized at 10% by two; and (c) multiplying market value of all shares by one. The total of (a), (b) and (c) above was then divided by six. The result was the "computed value using market quotations." This value was then assigned to the capital stock unless it was less than the net asset book value. In the latter event the value of the stock was considered to be the highest of; (a) 80% of net book asset value; (b) net book asset value less 25% of fixed assets not subject to local taxation; or (c) a value based on market quotations.

Variations of this formula were used for corporations not traded on a security exchange and closely held corporations.

On July 25, 1962, Massachusetts revised its law to eliminate the Corporate Excess (capital stock tax) provision in the Corporation Excise Tax Law and substituted a tax on tangible property located in Massachusetts and not subject to local taxation. Intangible property corporations were to be taxed on an allocated portion of net worth.

Exhibit B

ORGANIZATIONAL CHART
Department of Revenue



Proposed Organization - Department of Revenue